DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/84/261

CONFIDENTIAL

December 12, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Kenya - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a request from Kenya for a stand-by arrangement equivalent to SDR 85.2 million. A draft decision appears on page 35.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Jiménez (ext. 73707) or Mr. Simpson (ext. 75655).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

KENYA

Request for Stand-By Arrangement

Prepared by the African and the Exchange and Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by A.D. Ouattara and W.A. Beveridge

December 11, 1984

I. Introduction

In the attached letter dated November 21, 1984, the Government of Kenya requests a stand-by arrangement for calendar year 1985 in an amount equivalent to SDR 85.2 million, representing 60 percent of Kenya's quota. Of this amount, one half would be from the Fund's ordinary resources and the other half from borrowed resources under the enlarged access policy. The staff considers that access under the arrangement, at 60 percent of quota, is appropriate in order for the Fund to assist Kenya in covering its external financing gap through securing new donor country assistance and commercial borrowing on as advantageous terms as possible.

As of December 31, 1984, the Fund's holdings of Kenya shillings subject to repurchase are estimated to amount to SDR 387.6 million (273.0 percent of Kenya's quota), including SDR 60.4 million under the Compensatory Financing Facility, SDR 250.6 million under borrowed resources, and SDR 76.6 million under ordinary resources. The proposed stand-by arrangement, if fully utilized, would increase the Fund's holdings of Kenya shillings subject to repurchase to SDR 460.0 million (323.9 percent of quota) and SDR 357.6 million (251.8 percent of quota) under tranche policies (Table 1). Purchases under the arrangement will be phased in five installments: an installment of SDR 8.5 million following approval, two quarterly installments of SDR 21.3 million each and two other quarterly installments of SDR 17.0 million each. This phasing is related to the expected cash flow requirements for the financing of the balance of payments which indicate a substantial need in the first half of calendar year 1985. In addition, it is expected that Kenya will qualify for a purchase under the compensatory financing facility for cereal imports. The last Article IV consultation with Kenya was concluded by the Executive Board on May 16, 1984.

Table 1. Kenya: Fund Position During Period of Arrangement, December 1984 - December 1985

	Outstanding at beginning of arrangement December 31, 1984	1985 Jan.-Mar.	Apr.-June	July-Sept.	Oct.-Dec.
		(In millions of SDRs)			
Transactions under tranche policies (net) 1/		22.1	8.1	0.1	0.1
Purchases		29.8	21.3	17.0	17.0
Ordinary resources		(14.9)	(10.6)	(8.5)	(8.5)
Enlarged access resources		(14.9)	(10.6)	(8.5)	(8.5)
Repurchases		7.7	13.2	16.9	16.9
Ordinary resources		(5.7)	(9.0)	(11.3)	(10.6)
Other		(2.0)	(4.2)	(5.6)	(6.3)
Transactions under special facilities (net) 2/		--	57.0	-7.5	-7.5
Purchases		--	57.0	--	--
Repurchases		--	--	-7.5	-7.5
Total Fund credit outstanding (end of period)	387.6	409.7	474.8	467.4	460.0
Under tranche policies 1/	327.2	349.3	357.4	357.5	357.6
Under special facilities 2/	60.4	60.4	117.4	109.9	102.4
		(As percent of quota)			
Total Fund credit outstanding (end of period)	273.0	288.5	334.4	329.2	323.9
Under tranche policies 1/	230.5	246.0	251.7	251.8	251.8
Under special facilities 2/	42.5	42.5	82.7	77.4	72.1

Source: IMF, Treasurer's Department.
1/ Ordinary and enlarged access resources.
2/ Compensatory financing facility.

Recent economic developments and the performance under the just finalized stand-by arrangement are reviewed in Section II. The targets, assumptions, and principal elements of the proposed stabilization program are described in Section III, while the staff appraisal and the proposed decision are contained in Section IV.

II. Background and Performance Under Stand-by Arrangement

Kenya successfully carried out an economic financial program, which was supported by an 18-month stand-by arrangement for SDR 175.95 million (124 percent of Kenya's quota), which expired in September 1984, despite the emergence of a serious drought in 1984. All the drawings scheduled under the arrangement were carried out. In many respects, especially the balance of payments, which recorded overall surpluses in 1983 and 1984, developments exceeded the expectations at the start of the program and amply demonstrated the commitment of the authorities to the program, despite their need to implement additional measures during the program period.

When the program was launched at the end of 1982, Kenya had weathered an emergency following an attempted coup in August 1982, and faced difficult balance of payments prospects in a recessionary world economy, with a low level of gross international reserves, and serious domestic financial imbalances. In addition, the economy suffered from a number of serious structural problems, such as a high population growth rate, an inoperative development plan, a weak export sector, and a highly restrictive import system. The growth of agricultural output remained below its trend level in part because of difficult weather conditions in the early 1980s. Real GDP rose by over 4 percent on average during the period 1979-81, falling to an average of under 3 percent in 1982-83. Thus, over the five-year period ending in 1983 real growth barely kept up with the population growth rate which is estimated at close to 4 percent (Table 2).

As a result of the measures taken in the course of the last few years, the balance of payments current account deficit was reduced to a level that could be considered sustainable in the medium term. The current account deficit, which had reached the equivalent of over 11 percent of GDP in 1981, fell to 3.1 percent of GDP in 1983 and 3.4 percent of GDP in 1984. Balance of payments surpluses were recorded in 1983-84, allowing gross official reserves to rise from the equivalent of about 1.5 months of imports in 1981-82 to over 3 months of imports by the end of 1984. These developments were attributed to a strengthened export performance; tea exports more than doubled in the two years ending in 1984, while certain nontraditional exports also recorded strong gains. Although buoyant international market conditions provided an impetus to the tea sector, its performance and that of nontraditional exports was substantially helped by the pass through of international prices to producers and by an exchange rate policy which has sought to maintain the competitive position of the

Table 2. Kenya: Selected Economic and Financial Indicators, 1981-85

	1981	1982	1983	1984 Program	1984 Estimate	1985 Program
	(Annual percent changes, unless otherwise specified)					
National income and prices						
GDP at constant prices	4.1	1.8	3.9	4.0	--	4.0
GDP deflator	10.8	9.9	7.9	8.2	9.0	8.0
Consumer prices	20.2	14.4	10.1	8.0	10.0	9.0
External sector (on the basis of SDRs)						
Exports, f.o.b.	-5.6	-8.5	3.1	9.3	15.9	-1.6
Imports, c.i.f.	-9.7	-16.2	-15.9	9.9	17.7	8.1
Non-oil imports, c.i.f.	-16.0	-16.7	-15.1	13.6	25.5	11.1
Export volume	-5.2	--	7.1	2.9	0.3	4.0
Import volume	-21.8	-14.7	-9.0	5.1	15.8	5.4
Terms of trade (deterioration -)	-13.4	-6.8	4.2	2.1	13.4	-8.1
Nominal effective exchange rate (depreciation -) 1/	-15.4	-11.7	-2.5	...	-4.0	...
Real effective exchange rate (depreciation -) 1/	-7.7	-5.0	4.1	...	-5.0	-2.5
Government budget 2/						
Revenue and grants	20.3	12.4	7.6	10.9	9.2	17.3
Total expenditure	24.9	8.4	-3.6	12.2	12.6	18.1
Money and credit 2/						
Domestic credit	20.0	26.9	6.4	14.0	8.9	18.0
Government	74.6	55.1	-0.8	17.6	3.4	29.0
Other sectors	7.7	16.7	9.9	12.0	11.4	13.5
Money and quasi-money (M_2)	7.1	8.8	11.3	9.8	11.4	8.1
Velocity (GDP relative to M_2) 3/	3.31	3.47	3.63	3.98	3.44	3.52
Interest rate (annual rate) 3/						
Savings deposit (min.)	10.00	12.50	12.50	12.50	11.00	10.50
Average time deposit	10.75	13.75	13.75	13.75	12.75	11.75
Maximum lending rate	14.00	16.00	15.00	15.00	15.00	14.00
	(In percent of GDP)					
Government budget 2/						
Revenue and grants	26.1	25.7	24.8	22.4	24.6	26.0
Current expenditure	24.7	23.3	22.4	19.8	23.3	23.4
Current account surplus/deficit (-)	1.4	2.4	2.4	2.6	1.3	2.6
Development expenditure and net lending	10.1	9.8	6.2	6.7	7.8	7.9
Overall deficit 4/						
Including grants	9.5	6.6	3.1	4.1	4.6	5.1
Excluding grants	10.3	8.0	4.7	5.8	5.8	7.7
Domestic bank financing	2.8	2.6	-0.2	1.4	0.8	2.4
Foreign financing	4.9	1.7	1.7	1.2	1.0	1.6
Gross domestic investment	28.3	22.5	21.1	20.0	19.0	21.5
Gross domestic savings	19.3	17.8	19.3	16.2	16.8	18.2
External current account deficit 5/						
Including grants	11.1	7.4*	3.1	3.6	3.4	5.6*
Excluding grants	12.3	8.6*	5.2	5.1	5.9	7.8*
External debt						
External debt inclusive of Fund Fund credit (beginning of period)	39	41	47	36	49	46
Debt service ratio 6/	18	24	28	29	28	31
Interest payments 6/	10	13	11	10	11	12
	(In millions of SDRs, unless otherwise specified)					
Overall balance of payments 7/	-198	-150**	89	-24	50	-202**
Gross official reserves (months of imports)	1.4	1.6	3.5	2.0	3.2	2.7
External payments arrears	--	--	--	--	--	--

1/ December to December variations.
2/ Fiscal year ending June 30.
3/ Level in percent.
4/ Figures do not add up because of adjustment to cash basis.
5/ Asterisk * reflects severe constraint on foreign exchange availability.
6/ In percent of exports of goods and services.
7/ Double asterisk ** reflects severe constraint on foreign exchange availability.

export sector. Between February 1981 and October 1984 the Kenya shilling was depreciated by about 36 percent in terms of the SDR, through two discrete changes in October 1981 and December 1982 and a downward float thereafter. During the program period, the Government attempted to maintain the real effective rate established at the start of the program, which was in line with the rate in effect in the mid-1970s and considered to be broadly appropriate.

The domestic and external policies in place allowed for the liberalization of the import regime and the external payments system. In 1983 advance import deposit requirements were removed and during the year outstanding remittances for profits, dividends and fees for 1981-82 were cleared. A new import system was put in place in June 1983, facilitating the flow of imports. Import authorizations were allowed to rise at a fast rate even before the system was introduced due to improved foreign exchange availabilities. Import licenses rose by 28 percent in U.S. dollar terms during 1983, with a further small rise in 1984. As a result, the availability of imported goods has improved, quelling complaints in the private sector, and allowing an increase in capacity utilization.

Substantial progress was also made in adjusting domestic financial imbalances. The overall budgetary deficit, which had reached 9.5 percent of GDP in 1980/81 (July/June), was reduced to 3.1 percent in 1982/83 better than the program target of 4.7 percent (Table 3). The larger than expected reduction in that year reflects the carryover of a larger float than usual into the next fiscal year, as a result of development expenditures made at the end of the year following the receipt of some external resources. The deficit on a transaction basis only fell to 3.8 percent, still considerably below the program target.

The preliminary estimate for the cash deficit for 1983/84 is K Sh 3,647 million, or 4.6 percent of the revised GDP for 1983/84. The absolute figure is in line with the target of K Sh 3,702 million in the program, which included a reserve of K Sh 400 million, released when additional nonbank resources were obtained. The higher ratio of the deficit to GDP than programmed resulted from a lower GDP outturn than had been assumed in the program due to the drought. In order to meet the cash deficit target, the Government reduced expenditure below the programed level. Current expenditure bore the brunt of the reduction and there was some increase in development outlays.

Concomitant with the improvement in the budget since 1980/81, there was also a significant tightening of domestic monetary policy. Interest rates were raised at the start of the previous program by about 2-2.5 percentage points, following increases of 3-5 percentage points since 1980. These adjustments brought most rates to positive real levels. The The Central Bank also increased its surveillance of

Table 3. Kenya: Central Government Finance, 1980/81-1984/85

(In millions of Kenya shillings)

	1980/81	1981/82	1982/83	1983/84 Program	1983/84 Preliminary Actual	1984/85 Revised
Total revenue and grants	14,789	16,623	17,894	19,842	19,545	22,929
Total revenue	14,338	15,737	16,768	18,419	18,548	20,692
Foreign grants	451	886	1,126	1,423	997	2,237
Total expenditure and net lending	19,717	21,381	20,620	23,544 1/	23,213	27,407
Current expenditure	13,984	15,031	16,156	17,575	16,988	20,500
Development expenditure and net lending	5,733	6,350	4,464	5,969 1/	6,225	6,907
Overall deficit (Treasury accounts)	-4,928	-4,758	-2,726	-3,702 1/	-3,668	-4,478
Adjustment to financing basis 2/	-439	469	483	--	21	
Overall cash deficit	-5,366	-4,289	-2,243	-3,702 1/	-3,647	-4,478
Financing	5,366	4,289	2,243	3,702 1/	3,647	4,478
Foreign financing (net)	2,764	1,108	1,236	1,030	764	1,389
Drawings 3/	(3,498)	(2,238)	(2,718)	(2,894)	(2,487)	(3,463)
Repayments	(-734)	(-1,130)	(-1,482)	(-1,864)	(-1,723)	(-2,074)
Domestic financing	2,602	3,181	1,007	2,672 1/	2,883	3,089
Nonbank	(1,028)	(1,487)	(1,127)	(1,472)	(2,222)	(1,000)
Bank and CSFC	(1,574)	(1,694)	(-120)	(1,200)	(661)	(2,089)
Overall cash deficit excluding foreign grants	-5,817	-5,175	-3,369	-5,125	-4,644	-6,715
			(In percent of GDP) 4/			
Memorandum items:						
Total revenue and grants	26.1	25.7	24.8	22.4	24.6	26.2
Total revenue	25.3	24.4	23.2	20.8	23.3	23.6
Of which: tax revenue	21.8	21.4	19.8	18.3	20.3	20.5
Grants	0.8	1.4	1.6	1.6	1.3	2.6
Total expenditure and net lending	34.8	33.1	28.6	26.6	29.2	31.3
Current expenditure	24.7	23.3	22.4	19.8	21.3	23.4
Capital expenditure and net lending	10.1	9.8	6.2	6.7	7.8	7.9
Overall cash deficit	9.5	6.6	3.1	4.1	4.6	5.1
Overall cash deficit (excluding grants)	10.3	8.0	4.7	5.8	5.8	7.7
Foreign financing	4.9	1.7	1.7	1.2	1.0	1.6
Domestic financing	4.6	4.9	1.4	3.0	3.6	3.5
Of which: bank and CSFC	2.8	2.6	-0.2	1.4	0.8	2.4

Sources: Economic Survey, 1984; Statistical Abstract, 1983; and data provided by the Kenyan authorities.

1/ Includes K Sh 400 million in additional expenditure which was provided for in the program to the extent that at the time of the review it was demonstrated that foreign financing and nonbank financing was higher by this amount than envisaged in the program. The adjustment is made in both development expenditure and in nonbank lending.

2/ The adjustment factor arises because financing data are derived from different sources than revenue and expenditure data. It includes a float element resulting from some checks being issued but not cashed.

3/ Includes PL 480 and defense appropriations-in-aid loans.

4/ Staff estimates for GDP; original program estimate of GDP for 1983/84 was higher than the preliminary actual estimate.

financial institutions, especially nonbanks, with the aim of securing closer compliance with monetary policy initiatives. In the two fiscal years covered by the last program, the expansion of net domestic credit fell to an average of under 8 percent per annum, compared to over 23 percent per annum in the previous two fiscal years (Table 4). Credit to the private sector and public entities rose by 11 percent compared to 12 percent previously. The actual outturn for credit was much below the targets included in the program, which aimed at increasing domestic credit at an annual average of 15 percent. The lower level of domestic credit utilization was largely due to the improved outturn in the budget, which resulted in a net repayment to the banking system by the Government in 1982/83 and only a small increase in 1983/84. Credit to the rest of the economy also fell below the target of 14 percent set in the program.

Incentives in the agricultural sector have been maintained in the context of yearly reviews of producer prices. Producer prices for maize and wheat were raised by 82 percent and 64 percent in the four years ended in 1984, compared to an increase of about 65 percent in the cost of living during the same period. These policies helped to provide crop surpluses in 1982 and 1983, allowing for some exports and the buildup of a strategic grain reserve. Proceeds from exports are largely passed on to producers.

The Government has continued to pursue a cautious incomes policy, permitting increases in private sector wages sufficient to compensate only up to 75 percent in the rise of the cost of living. In addition, there have been no cost of living adjustments in the public sector since 1981, despite an increase in the cost of living of about 39 percent since then.

Although the growth rate of real GDP fell to only 1.8 percent in 1982, its rise to 3.9 percent in 1983 augured the start of a sustained expansion in income (Appendix Table I). At the same time, a slowdown in the rise of consumer prices was evident. The rise in consumer prices, which exceeded 20 percent in 1981, has fallen to an average of about 10 percent in 1983-84 (Appendix Table II).

The successful implementation of the 1983-84 program considerably lessened the domestic and external imbalances and has permitted the Government to focus on the structural problems in the economy. Toward this end, a new Five-Year Development Plan was announced for implementation beginning with the 1984/85 fiscal year. The plan received a favorable review from the World Bank during the Consultative Group Meeting for Kenya in early 1984. The plan aimed at maintaining a viable balance of payments position in the medium term, strengthening export performance, and gradually improving the growth of real GDP. It recognized the need to generate additional domestic resources for develepment and to maintain the overall budget deficit at a sustainable level, while assuring adequate domestic financing for the rest of the economy.

Table 4. Kenya: Monetary Survey, 1982-1984

	June 1982	June 1983		June 1984	
	Actual	Program	Actual	Program	Actual
Net foreign assets	-921	-1,400	-122	-500	307
Total domestic credit	21,599	24,794	22,990	26,286	25,030
	(26.9)	(14.8)	(6.4)	(14.3)	(8.9)
Government (net)	7,028	8,053	6,973	8,173	7,194
	(55.1)	(14.6)	(-0.8)	(17.2)	(3.4)
Public entities	626	626	1,196)		2,399
	(36.1)	(--)	(91.1))	18,113	(100.6)
Private sector	13,945	16,115	14,821)	(13.1)	15,437
	(8.8)	(15.6)	(6.3))		(4.2)
Other items (net)	1,974	2,200	2,100	2,350	2,198
Advance import deposits	47	--	--	--	--
Money and quasi-money	18,659	21,194	20,768	23,436	23,139
	(8.8)	(13.3)	(11.3)	(12.8)	(11.4)

Sources: Data provided by the Central Bank of Kenya; and staff estimates.

Kenya's prospects suffered a major reversal in 1984 with the emergence of one of the worst droughts in the country's history. The "long rains," which provide for the main grain harvest, failed in the principal producing areas, reducing grain availability to almost half. The rest of the agricultural sector was also affected, with a particularly adverse impact being experienced by the coffee and tea sectors. In addition, the drought devastated the livestock herd and had a major negative impact on dairy output. The fall in the water level in some of the major dams resulted in the need to shift to thermal production of electricity. The crisis is having a considerable negative impact on income, the budget, and the balance of payments. However, the economic adjustment previously undertaken by Kenya has placed the country in a better position to meet the current crisis. The adequate incentives granted to the agricultural sector in recent years had allowed an important strategic grain reserve to be built-up. Having reduced the underlying domestic and foreign deficits to almost sustainable levels, Kenya can better address the extraordinary financing needs generated by the drought relief. The magnitude of the problem has required a shift in government policy to focus on the crisis.

The impact of the drought has been far reaching. Real GDP is likely to show no growth at all in 1984 and perhaps even record a small reduction. The sporadic food shortages which have occurred have built-up some additional pressure on prices. Presently, prices are projected to record an increase of about 10 percent in 1984, compared to a previous estimate of about 8 percent.

Even after using a part of the strategic grain reserves, Kenya will need to import about 400 thousand metric tons of wheat and 1 million metric tons of maize in the 18 months ending December 1985. This corresponds to about half the estimated grain consumption during this period. The import cost of the grain is estimated at over SDR 230 million. There is also a need for larger imports of milk products and other food products. The direct impact on exports is estimated to involve a loss of export earnings largely of tea and petroleum products of about SDR 50 million. The loss would have been greater but for the rundown of coffee stocks to allow Kenya meet its quota commitments. These developments will lead to a deterioration in the balance of payments, with the emergence of a large overall deficit in 1985, but of a magnitude smaller than the impact of the drought on the balance of payments.

The need to distribute such large quantities of grain is generating a major administrative burden which requires a reorganization of the transport system, not only to assure the timely distribution of the grains, but also to minimize disturbing effects on economic activity. Although initially it was believed that most of the grain could be sent up country by railroad, a large part will now have to be moved by trucks, at over twice the transportation cost. Moreover, an important proportion of the grain will need to be distributed for hunger relief. These elements are generating a major financial impact on government finances.

III. The 1985 Financial Program

1. Introduction

The proposed program aims at providing balance of payments support within a framework designed to maintain the underlying budgetary and balance of payments deficits at sustainable levels in the medium term. It seeks to minimize the disturbance on economic activity arising from the drought and its relief. It balances the emergency requirements with the need to allocate sufficient resources to maintain the underlying flow of economic activity. This approach requires the containment of the budgetary deficit and the continuation of cautious financial policies. The program assumes that in 1985 rainfall will return to its normal pattern and quantity, allowing for the recuperation of the agricultural sector. This assumption has been bolstered by the arrival of the 1984 "short rains" on schedule.

The proposed financial program has been formulated in the context of a medium-term strategy aimed at reducing the fiscal and external current account deficits to about 4 percent in 1986 and to 3.5 percent of GDP in the latter part of the 1980's. This strategy also provides for real growth rate of about 5 percent in 1986 rising to 6 percent by the end of the decade, and an inflation rate contained to within 6-7 percent throughout this period. Domestic credit policies will be adjusted in accordance with these objectives.

Given the extraordinary transport requirements for the distribution of the grains to the countryside, the Government found it necessary to increase consumer prices by a wider margin than the rise in producer prices in order to strenghten the financial position of the National Cereals and Produce Board (NCPB). Consequently, the consumer price of maize was increased by 15 percent compared to a rise of 9 percent in producer prices. The Government is committed to continue its annual revision of producer prices.

The incomes policy will remain unchanged, with no cost of living increase planned in the public sector in 1984/85.

As a result of the financing requirements of the drought relief and the domestic and external policies announced by the authorities, the current account deficit of the balance of payments is expected to rise from 3.1 percent of GDP in 1983 to 3.4 percent in 1984 and 5.6 percent in 1985 (Table 5). Staff estimates indicate that about 2.5 percentage points of the increase in the current account deficit (excluding official grants) in 1985 is related to the drought. Consequently,

Table 5. Kenya: Balance of Payments, 1981-85

(In millions of SDRs)

	1981	1982	1983	1984 Revised program 1/	1984 Proj.	1985 Program
Current account	-606	-421	-163	-218	-195	-346
Trade balance	-935	-713	-440	-564	-533	-673
Exports, f.o.b.	(915)	(837)	(863)	(945)	(1,000)	(984)
Imports, c.i.f.	(-1,850)	(-1,550)	(-1,303)	(-1,510)	(-1,533)	(-1,657)
Services (net)	248	231	169	239	204	196
Transfers (net)	81	61	108	107	134	131
Capital account	401	271	252	218	245	144
Long-term	312	227	165	218	201	97
Official	(175)	(145)	(75)	(153)	(142)	(32)
Private	(137)	(82)	(90)	(65)	(59)	(65)
Short-term 2/	89	44	87	--	44	47
Allocation of SDRs	7	--	--	--	--	--
Overall balance	-198	-150	89	--	50	-202
Financing	198	150	-89	--	-50	202
Gross reserves (increase -)	176	6	-169	12	-24	36
IMF (net)	23	135	88	-12	-12	73
Other assets (net)	-1	9	-8	--	-14	--
To be secured	--	--	--	--	--	93
Memorandum items:						
Gross reserves (in months of imports)	1.4	1.6	3.5	2.8	3.2	2.7
Current account/GDP (in percent)						
Including official grants	11.1	7.4	3.1	3.4	3.4	5.6
Excluding official grants	12.3	8.6	5.2	5.2	5.9	7.8
Official net capital inflows plus official grants	4.9	3.8	3.5	3.9	4.5	2.7

Sources: Data provided by the Kenyan authorities; and staff estimates.

1/ As contained in EBS/84/79.
2/ Includes changes in net foreign position of the commercial banks, valuation adjustments, and net errors and omissions.

with the return of normal weather conditions it is expected that the current account deficit will return to a sustainable level in the medium-term. In 1984, given the underlying strength of the balance of payments and the receipt of some of the drought assistance during this year, it is expected that the balance of payments will record an overall surplus equivalent to SDR 50 million (0.8 percent of GDP). The bulk of the needed grain imports, however, will flow in 1985 leading to an increase in the current account deficit and resulting in a projected overall balance of payments deficit of about SDR 202 million. After taking into account a drawdown of official reserves and the financing to be provided through the proposed stand-by arrangement and a possible CFF purchase, a balance of payments financing gap of about SDR 93 million remains. The authorities are taking steps to fill this gap through a combination of increased donor support and some borrowing on commercial terms.

The proposed stand-by arrangement contains the following performance criteria:

a. Quarterly ceilings on total domestic credit of the banking system;

b. Quarterly subceilings on net bank credit to the Central Government;

c. A ceiling on external loans contracted or guaranteed by the Government on commercial terms in a maturity range of 1-12 years, with a subceiling on loans in the maturity range of 1-5 years, and an embargo on short-term borrowing except when trade-related;

d. A review of fiscal, monetary, exchange rate, and import policies before June 30, 1985; and

e. The standard provisions relating to multiple currency practices, bilateral payments arrangements, and restrictions on payments and transfers for current international transactions and on imports for balance of payments reasons.

The quantitative performance criteria are summarized in Table 6 and a summary of the measures is provided in Table 7. The credit ceilings are to be adjusted downwards by any balance of payments support which passes through the budget and which is not presently accounted for in the program. Credit ceilings have been fixed through June 30, 1985. Ceilings for the remainder of the program period will be determined during the review, when the 1985/86 budget will also be discussed.

Table 6. Kenya: Quantitative Performance Criteria

	1984 March 1/	1984 June 1/	1984 Sept.	1984 Dec. Proposed	1985 March Proposed	1985 June Proposed
	(In millions of Kenya shillings)					
Total domestic bank credit						
Ceiling	26,365	26,286		28,365	27,913 2/	29,527 2/
Actual	23,886	25,030	27,722			
Net bank credit to the Government						
Ceiling	7,154	6,927		9,245	8,754 2/	8,638 2/
Banking system	8,400	8,173		9,890	9,399	9,283
Eurocurrency	--	--		--	--	--
CSFC	-1,246	-1,246		-645	-645	-645
Actual	5,500	6,549	8,919			
Banking system	6,581	7,194	9,355			
Eurocurrency	--	--	--			
CSFC	-1,081	-645	-436			
New external borrowing contracted or guaranteed by the Government (cumulative)	(In millions of U.S. dollars)					
1-12 years' maturity						
Ceiling	150	150		150	150	150
Actual	--	--	--			
1-5 years' maturity						
Ceiling	100	100		100	100	100
Actual	--	--	--			

Source: Central Bank of Kenya; and staff estimates.

1/ Ceilings refer to 1983/84 program.
2/ Ceiling adjustable downwards, if specified gap financing is undertaken by Government.

Table 7. Kenya: Policy Measures Under the Stand-by Program: Current Status of Implementation

Program	Current status of implementation
1. Price measures	
a. In line with adjustments effected in previous years, retail prices of maize and wheat to be increased by 15 percent and 20 percent respectively. The magnitude of consumer prices changes exceed those in producer prices introduced earlier in the year. On average, producer prices of maize and wheat have been raised by over 18 percent and 13 percent during the last five years.	Implemented September 19.
2. Drought emergency measures	
In the wake of the drought, government efforts have concentrated on promoting production and improving distribution of main food staples, while minimizing drought-related financial imbalances. To attain these goals the government has approved the following measures:	
a. Utilization of one third of the strategic maize reserves accumulated during the last few years, before the end of 1984.	Implemented.
b. Importation of 1.4 million metric tons of grain.	Under way.

Table 7. Kenya: Policy Measures Under the Stand-by Program: Current Status of Implementation (continued)

Program	Current status of implementation
c. Redeployment of the country's transportation network to facilitate the movement of grain imports from the port of delivery to silos and inland distribution centers. Available grants and loans for highway and rail transportation equipment and spare parts being sought.	Under way.
d. The increase in domestic consumer prices of maize and wheat to cover transportation costs of commercial imports.	Implemented.
3. Fiscal measures	
a. New tax measures to yield K Sh 364 million for the entire fiscal year. An average reduction of 14 percent in import duty rates of 25 percent or more, was offset by an increase in sales tax rates (now ranging from 17 percent to 100 percent) with a net revenue increase of K Sh 186 million. Increases in excise taxes on cigarettes and matches and in the air passenger tax (from K Sh 100 to US$10) are projected to add K Sh 160 million and K Sh 18 million, respectively, to total tax revenue.	Implemented with the 1984/85 fiscal budget.
b. Cutbacks equivalent to K Sh 300 million in the recurrent expenditure provided in the 1984/85 budget, mainly through a 10 percent across-the-board reduction in all categories of expenditure with the exception of wages and salaries, interest payments and transfers.	Implemented in September 1984.

Table 7. Kenya: Policy Measures Under the Stand-by Program: Current Status of Implementation (continued)

Program	Current status of implementation
c. Economies of K Sh 271 million in development expenditure, largely relating to transfers and loans to parastatals and postponement of infrastructure projects.	Implemented in September 1984.
d. The 1984/85 budget does not provide for a general wage increase. In addition, vacant positions in the civil service are not being filled (except for technical positions deemed to be absolutely necessary), and payments to other than legitimate civil servants have been prevented through compulsory registration of the latter.	Employment and wage policies being implemented within the frame of the 1984/85 budget. The registration of civil servants took place on October 6.
4. <u>Monetary measures</u>	
a. Government committed to maintain interest rates at positive levels. With a rate of inflation of about 10 percent, real interest rates range from 2 percent to 5 percent.	Policy in effect.
b. Limits on overall credit and net credit to government by the banking system.	Performance criteria in the program.
5. <u>External sector measures</u>	
a. The level of the exchange rate will be kept under continuous review during the program period.	In progress. The value of the Kenya shilling vis-à-vis the SDR

Table 7. Kenya: Policy Measures Under the Stand-by Program: Current Status of Implementation (continued)

Program	Current status of implementation
	has depreciated by about 38 percent since February 1981. The real effective exchange rate of the Kenya shilling has returned to the level prevailing in the middle 1970's, a period of strong balance of payments position and a freer import system.
b. Limits on new government or government-guaranteed external debt with maturities below 5 years and below 12 years. Embargo on short-term debt other than trade related.	Performance criteria in the program.
c. Trade liberalization.	The process of import liberalization is being implemented in conjunction with the program's cautious demand management policies and a flexible exchange rate policy. The Government's approach to a freer import system is two-pronged: (a) maintenance of the presently liberal implementation of the license system, through an increase in the value of licenses approved and in the availability of goods, even in the more restrictive categories (actual non-government, non-oil imports are estimated

Table 7. Kenya: Policy Measures Under the Stand-by Program: Current Status of Implementation (concluded)

Program	Current status of implementation
	to have risen by 20 percent in 1984); and (b) a shift of 30 percent of items in Schedule 1B to 1A by June 30, 1985, while effecting further transfers from Schedule 2A to 1B.

2. Budgetary policies

In the fiscal sector, the principal objective of the program is to preserve the substantial adjustment which has taken place in the overall budget deficit since 1980/81, while allowing for the drought emergency needs. The fiscal program is based on a revised 1984/85 budget. It incorporates the expected impact of the drought on revenue and expenditure, it reduces provisions for certain categories in the initial budget, and takes account of the increase in consumer grain prices. The expenditure estimate already incorporates the normal mid-year supplementary budget increases, including the underprovision for personal emoluments for teachers and some Ministry of Health expenditure. It also takes account of the extraordinary assistance which donors had committed as of October 1984. The net impact of these adjustments is an overall budget deficit of K Sh 4,478 million, equivalent to 5.1 percent of GDP. It is expected that, before the fiscal year ends, additional foreign grants and loans will be received, reducing the overall deficit and domestic financing. The program envisages automatic reductions in bank credit to the Government as this additional financing becomes available. Excluding the effects of the drought, the 1984/85 budget aims at a small further improvement in the underlying budget deficit to about 4.1 percent of GDP, compared to 4.6 percent of GDP in 1983/84. This represents continued adjustment in the fiscal area toward a sustainable position. Excluding the assistance already received related to the drought, it is estimated that the drought would have an impact on the budget of 1.4 percent of GDP.

The revised budget for 1984/85 projects total revenue equivalent to 23.6 percent of GDP, compared to 23.3 percent estimated for 1983/84. Without the drought it is estimated that total revenue would have reached the equivalent of 24.0 percent of GDP. Foreign grants are estimated at the equivalent of 2.6 percent of GDP, of which 0.5 percentage points are related to drought assistance. In 1983/84 foreign grants only totaled 1.3 percent of GDP. Total revenue and grants are expected to reach 26.2 percent of GDP in 1984/85, compared to 24.6 percent in the previous fiscal year.

The program contains tax measures which are estimated to provide a net increase in revenue of K Sh 364 million, equivalent to 0.4 percent of GDP. In the last two fiscal years new revenue measures have been introduced yielding, on average, a net increase of 0.5 percent of GDP in additional revenues notwithstanding measures taken to reduce the level of import tariffs. In 1983/84 the Government reduced the duty on imports with a rate exceeding 30 percent by an average of 15 percent. In 1984/85 further action in reducing protection was taken by downward adjustments of most import duties in excess of 25 percent by an average of 14 percent. As in the previous year, there was an increase in sales tax rates to offset the revenue loss, particularly on certain luxury goods such as automobiles, photographic equipment, and electrical appliances. To facilitate the administration of the sales tax, the system was simplified by reducing the number of duty rates to only five, ranging from 17 percent to 100 percent. The increase in revenue from the sales tax changes is estimated to exceed the loss from the custom duty adjustments by about K Sh 186 million. Among the other - revenue measures undertaken was an increase in excise duties on cigarettes and matches estimated to yield an additional K Sh 160 million and an upward adjustment in the air passenger tax estimated to yield an additional K Sh 18 million.

The revised forecast for 1984/85 has been estimated on the basis of actual revenue collections during the first quarter of the year, and taking only into account grant commitments from donors which are regarded as firm.

Expenditure and net lending is expected to rise to the equivalent of 31.3 percent of GDP in 1984/85, compared to 29.2 percent in the previous fiscal year. Current expenditure is estimated to total the equivalent of 23.4 percent of GDP compared to 21.3 percent in 1983/84, while development outlays and net lending are projected at 7.9 percent of GDP compared to 7.8 percent in the previous fiscal year. The increase in current expenditure contrasts with a declining ratio of current outlays to GDP in the previous four years. The drought-related expenditure accounts for about one half of the rise. The National Cereals and Produce Board (NCPB) has been allocated a transfer payment of K Sh 900 million to finance food grain distribution. This sum arises because NCPB has to finance the distribution of grains received as grants from abroad. Even when the grain is sold commercially, the proceeds do not accrue to NCPB, but to the Government. According to the aid agreements with most donors, the local counterpart from the sales must be used for projects specified in the agreements. The authorities are attempting to have transportation costs of grain distribution as one of the specific uses of these resources. The 1984/85 operations of NCPB will be financed through the budget and not through the banking system. Strict control has been maintained in most expenditure categories, including personnel expenses. In an effort to contain wage expenditure, the budget for 1984/85 provides for no general wage increase and the authorities have recently required the registration of all civil servants in order to assure that there are no payments being made to phantom government employees. This exercise is also helping the Government estimate the number of vacant positions in the civil service. It is the authorities' objective not to fill these positions with the exception of technical positions which are deemed essential and those that may be required for grain distribution.

Development outlays and net lending are expected to increase faster than GDP for the second year in a row in 1984/85, following 3 years of reductions. Despite the most recent increases, development outlays and net lending at under 8 percent of GDP are still below the level reached in 1980/81 of over 10 percent. A larger increase would have been necessary, if the new development plan had been implemented on schedule. The program incorporates most of the ongoing projects included in the development plan which have a high component of foreign financing. The cuts in the development program were designed mainly to reduce the locally-funded component. Most of the cuts relate to projects not yet started or in the early stages of implementation. In addition, the 1984/85 development outlays have been restructured in order to allow for labor intensive projects to be utilized in "work for food" programs in the countryside.

Net foreign financing is estimated at K Sh 1,389 million, or 31 percent of the total deficit. Gross drawings are expected to rise by almost 40 percent to K Sh 3,463 million. About half of the increase will be offset by a rise in amortization payments. Over the last four years amortization payments have almost tripled, reflecting the rise of Kenya's debt service burden. Net nonbank financing is estimated at K Sh 1,000 million, or less than half of the amount recorded in 1983/84, when an extraordinary effort to obtain financing from this source was carried out. This cannot be repeated without hindering the ability of nonbank institutions to fund private sector activities. As of June 1984 net credit to the Government accounted for 19 percent of the domestic credit of nonbank financial institutions compared to 17 percent in June 1983. The increase recorded in the last fiscal year was facilitated by the nonbank institutions having deficiencies with respect to their liquidity requirements and by a large purchase of Treasury bills by the National Social Security Fund (NSSF), which is required to invest its surplus resources in government securities. An effort is being made to increase the share of nonbank financing in the form of long-term government issues, particularly with regard to NSSF, while reducing the share in the form of Treasury bills to provide better debt management. The program seeks to contain net bank financing to the Government to K Sh 2,089 million, equivalent to about 2.4 percent of GDP, compared to less than 1 percent of GDP in 1983/84. The rise is explained largely by the financing requirements of the drought relief. However, it is expected that both the budget deficit and net bank financing will turn out to be lower than presently estimated as more foreign assistance is confirmed. The program has utilized a conservative estimate for the level of foreign grants and loans.

Budget operations have a marked seasonality, involving a substantial overall deficit in the first quarter of the fiscal year, a further but smaller increase in the second quarter, and then large reductions in the subsequent two quarters. The seasonality arises largely because revenues are concentrated in the latter part of the year as a result of the payment of most corporate income taxes in March and April. The receipt of foreign loans and grants is also concentrated in the latter part of the year, because much of these resources are reimbursed only after expenditures have been carried out. The ceilings established on net credit to the Government are based on quarterly projections of most components of the budget taking into account the normal seasonality and the special factors influencing 1984/85, particularly the cash flow impact of the drought relief.

Although substantial progress has been recorded in adjusting the overall budgetary deficit in the last few years, additional actions will be required with the 1985/86 budget. Such adjustments should bring the overall budget deficit to under 4 percent of GDP, with a reduction in net bank financing. Important adjustments will also have to be made in the structure of expenditures, as a greater implementation of the development plan takes place.

3. Public enterprises

Public enterprises play a major role in Kenya's economy. Apart from the statutory boards there are 47 wholly owned enterprises and more than 100 companies with government majority or minority participation engaged in a wide variety of economic activities. Many of the latter are controlled through the wholly owned enterprises. In the recent past the Government has attempted to monitor their activities more closely, with the aim of reducing the net drain on the budget and selecting investments to be sold to the private sector. An Investment Division was created within the Ministry of Finance to monitor all financial flows between the enterprises and the Treasury to facilitate repayment of loans and the receipt of profits. The Division has also begun compiling financial information on the major public enterprises to strengthen the information base available to decision makers and to prepare a centralized forecast of enterprises' investments for incorporation in the Development Plan and annual forward budget exercises. While many of the commercial enterprises have made profits, some have made significant losses. Apparently, the Government has failed to receive its share of profits, although it has helped finance some of the losses. Deposits of public enterprises in banks and nonbanks have recorded a large increase in the last three years.

The progress in securing better control of the public enterprises has suffered some important delays. The State Corporations Act, a bill to be approved by Parliament which would provide the Government with the legal backing for extending its supervision, collecting more money from the enterprises, and selling its share in some, suffered a series of legal roadblocks and has not yet been submitted to Parliament. In the legal review of the draft bill, the authorities found out that they lacked the necessary power to control the public enterprises, as many of them had their own Acts of Parliament or specific charters giving them a degree of autonomy. Consequently, a case by case review of the enterprise's incorporation certificates was needed to devise an adequate mechanism for establishing the central control sought in the State Corporations Act. It may even be that the possibility of using an instrument such as the State Corporations Act may not prove legally possible and a case by case approach of revising individual charters may be necessary. The authorities have been cautious in these efforts, as many enterprises are co-owned with domestic or foreign private investors, and they do not want to create an atmosphere that could discourage additional private investment. Meanwhile, the efforts of the Investment Division have not progressed as quickly as hoped because records and accounts of many enterprises are deficient and co-operation has been inadequate. In addition, there is a shortage of technical staff to review and reconstruct financial accounts. Consequently, the Division has been working on a schedule that allows them to review about one wholly-owned enterprise per month. Apart from establishing more uniform accounting procedures, the Division has sought to ascertain the amount of government resources that have been transferred to these enterprises and to get agreement on the proportion that will be allocated to equity and what will need to be repaid to the Treasury. The conditions of repayment are also being negotiated. In this process an effort is being made to ascertain which enterprises are not viable and which could be sold. Meanwhile, the financial analysis which is being undertaken is permitting the preparation of information to integrate the accounts of the public enterprises in the forward budget. Further progress is expected in this area during the current fiscal year, leading to the integration of major public enterprises into the forward budget process in the next fiscal year.

4. Monetary and credit policies

The financial policies under the proposed program aim at keeping the rate of increase in money and quasi-money to a prudent level, while facilitating drought relief and allocating sufficient resources to the rest of the economy to maintain the underlying trend of economic activity. These policies, in coordination with the interest rate and budgetary policies, should improve the utilization of financial resources and promote price stability. The program will permit an acceleration of domestic bank credit in fiscal year 1984/85 in part reflecting the drought relief needs and the balance of payments deficit expected during this period. As mentioned earlier, it is expected that some of the balance of payments financing to be obtained by the Government will be utilized through the budget, thereby automatically reducing the overall credit expansion and the net utilization of bank credit by the Government. Consequently, even though the program permits an expansion of total domestic credit equivalent to 16.2 percent of the initial stock of money and quasi-money; the actual growth is expected to be considerably less (Table 8). Importantly, the program envisages credit to the private enterprises and public entities to increase by 13.5 percent, slightly higher than the expected growth of nominal GDP. However, Kenya has established a record over the last programs of underutilizing its margin of credit. This development may be repeated,

Table 8. Kenya: Monetary Survey, 1983-85

	1983				1984				Projections 1985	
	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.	Mar.	June
	(In millions of Kenya shillings)									
Net foreign assets	-1,143	-122	-1,200	-534	-187	307	-269	-75	-536 1/	-1,763 1/
Total domestic credit	23,637	22,990	24,435	25,374	23,886	25,030	27,722	28,365	27,913 2/	29,527 2/
	(9.8)	(6.4)	(-0.0)	(0.1)	(1.1)	(8.9)	(13.5)	(11.8)	(16.9)	(18.0)
Government (net)	8,015	6,973	8,130	8,141	6,581	7,194	9,355	9,890	9,399 2/	9,283 2/
	(6.1)	(-0.8)	(-15.2)	(-18.5)	(-17.9)	(3.4)	(15.1)	(21.5)	(42.8)	(29.0)
Public entities	1,047	1,196	1,342	1,854	2,082	2,399	2,192)			
	(183.0)	(91.1)	(129.4)	(85.6)	(98.9)	(100.6)	(63.3))	18,475	18,514	20,244
Private sector	14,575	14,821	14,963	15,379	15,223	15,437	16,175)	(7.2)	(7.0)	(13.5)
	(7.1)	(6.3)	(4.8)	(7.1)	(4.4)	(4.2)	(8.1))			
Other items (net)	1,078	2,100	1,593	2,002	852	2,198	2,887	2,500	2,100	2,000
Foreign borrowing counterpart to domestic credit	--	--	--	--	--	--	--	--	374	753
Money and quasi-money	21,416	20,768	21,640	22,838	22,847	23,139	24,566	25,790	24,903	25,011
	(13.1)	(11.3)	(9.0)	(6.5)	(6.7)	(11.4)	(13.5)	(12.9)	(9.0)	(8.1)
Money	10,860	10,611	10,948	11,945	12,213	12,407	...	...	...	...
Quasi-money	9,996	10,157	10,401	10,893	10,634	10,732	...	...	...	...
Memorandum item:										
Gap financing	--	--	--	--	--	--	--	--	374	753
	(Changes as a ratio to the stock of money and quasi-money 12 months earlier)									
Net foreign assets	-3.6	4.3	3.8	4.9	4.5	2.1	4.3	2.0	-1.5	-8.9
Total domestic credit	11.1	7.5	--	0.1	1.2	9.9	15.2	13.1	17.6	19.4
Government (net)	2.4	-0.3	-7.3	-8.6	-6.7	1.2	5.7)	7.7	12.3	9.0
Other public entities	3.6	3.1	3.8	4.0	4.8	5.8	3.9)	5.4	5.3	10.4
Private sector	5.1	4.7	3.5	4.7	3.0	2.9	5.6)			

Source: Data provided by the Central Bank of Kenya; and staff estimates.

1/ Excludes gap financing requirements of K Sh 374 million in first quarter and K Sh 753 million in first half.
2/ Ceiling adjustable downwards, if specified gap financing is undertaken by Government.

given the continued depressed conditions in private sector activity. Given the large balance of payments deficit expected in 1985, the targeted credit growth is consistent with a deceleration in the growth of money and quasi-money to about 8 percent by June 1985 compared with 13 percent in calendar year 1984 resulting in a modest increase in velocity.

5. External policies

In the external sector the program's objectives are to limit the deterioration in the balance of payments resulting from the drought, to further the process of import liberalization, and to avoid any erosion of Kenya's external competitive position. In addition, the program aims at preserving an adequate reserve position, while limiting the deterioration of Kenya's debt service ratio. To achieve these goals, Kenya will need to follow cautious domestic economic and financial policies, and to seek the necessary additional financing on as favorable terms as possible.

Although the program allows for a deterioration in the current account deficit of the balance of payments to 5.6 percent in 1985, it is expected to be reduced rapidly in the following years. The widening of the current account deficit in 1985 takes into account the balance of payments impact of the drought and an acceleration in import growth associated with the relaxation of import controls.

The balance of payments will be under pressure not only because of drought related import requirements and damage to export production, but also because the presently firm market conditions for Kenya's major exports are not projected to be sustained in 1985. Tea and coffee export prices are expected to fall by 16 percent and 9 percent respectively but prices will still remain high in comparison to past levels. The surpluses of refined oil products available for export are projected to be sharply reduced as a result of their use for thermal electricity generation. These developments, in association with a fall in volumes arising from the drought are estimated to lead to a decline in exports in SDR terms of around 2 percent. Drought related imported grain requirements are presently projected at around SDR 150 million, estimated to contribute around 8 percent to the rise in the total import bill. The program also provides for a 7 percent increase in nonfood, nonpetroleum imports (about 4 percent in real terms).

In 1985 net service earnings are projected to fall slightly to SDR 196 million, largely as a result of increased outflows of investment income, reflecting the assumption that most of the balance of payments deficit will be covered by commercial borrowing. The availability of concessional borrowing will reduce interest payments substantially. Net transfers are expected to remain at about the 1984 level, which is about 60 percent larger than the average of the previous three years, reflecting new firm commitments from donors. This item is likely to be larger as more donor assistance is generated.

On the basis of firm commitments already made, capital inflows are expected to fall considerably below the average level recorded in the previous years. However, the lower level presently projected arises because some additional assistance is being given in grant form, and because the Government's slower implementation of the development plan has reduced the utilization of contracted loans, and its delays in arranging the support for drought relief. As the financing gap for 1985 is closed, net capital inflows will increase to about the levels recorded in the previous two years.

The medium-term outlook for Kenya's balance of payments remains viable as presented in the Staff Report to the 1984 Article IV Consultation and Review Under Stand-by Arrangement (EBS/84/79, 4/5/84) despite the special difficulties being faced in 1985. A revision is included in Table 9. The current account deficit is projected to fall to 3.5 percent of GDP by 1989. Export growth is expected to average 11 percent a year between 1985 and 1989. Of this, around 5.5 percent represents an increase in volume terms, the same rate of expansion as real GDP. Performance in the tea sector is anticipated to be particularly good once the effects of the drought have been overcome; as a result of the extensive new planting program undertaken recently, production should grow by around 9 percent a year from 1986 until the end of the decade. The relatively low growth projected for imports in the medium-term (about 7 percent a year in value terms) is attributable to a sharp fall in food imports after 1985. However, reflecting the on-going process of import liberalization, the expansion of non-oil imports, other than that by the Government, is expected to continue in real terms at rates in excess of GDP growth. It has been assumed that both export and import prices will rise by about 5 percent per year, leaving the terms of trade unchanged.

The surplus on services account is expected to decline as a percentage of GDP from over 3 percent in 1985 to around 2.5 percent in 1989. While the growth of earnings from travel and freight insurance should continue at their present levels, receipts from these sources will be more than offset by the growing interest burden of servicing Kenya's external debt. In 1986, once no further drought-related assistance is required, official grants are expected to decline to a little over 1 percent of GDP; the medium-term projections assume that this level will be maintained thereafter.

It has been assumed that the current account deficits will be financed by long-term net capital inflows equivalent to around 3.5 percent of GDP, of which 2.5 percent represents net official borrowing. After providing for reserve accumulation necessary to maintain a reserve level at about 2.5 months of imports and for repurchases to the Fund, Kenya will need to contract additional medium- and long-term loans in the context of the current development plan. These loans are projected to amount to a maximum of SDR 100 million per year, equivalent to a decline in terms of GDP from 1.4 percent in 1986 to 1.0 percent in 1989. The staff does not envisage that any difficulties will be encountered in covering this gap; between 1978 and 1983 long-term net capital inflows,

Table 9. Kenya: Medium-Term Balance of Payments Projections, 1984-1989 1/

	1984	1985	1986	1987	1988	1989
	(In millions of SDRs)					
A. Exports, f.o.b.	1,000	984	1,087	1,204	1,327	1,476
Tea	266	232	260	299	343	395
Coffee	264	245	263	284	308	333
Oil products	121	126	140	149	158	168
Other	349	381	424	472	518	580
B. Imports, c.i.f.	-1,533	-1,657	-1,660	-1,812	-1,985	-2,179
Government	-206	-253	-125	-134	-144	-154
Food	(-106)	(-149)	(-14)	(-14)	(-15)	(-16)
Other	(-100)	(-104)	(-111)	(-120)	(-129)	(-138)
Oil	-487	-495	-525	-557	-591	-621
Other	-840	-908	-1,009	-1,120	-1,250	-1,404
C. Trade balance (A+B)	-533	-673	-573	-608	-658	-703
D. Services (net)	204	196	206	218	235	250
E. Private transfers	-6	-6	-6	-4	-2	--
F. Official transfers	140	137	86	96	107	118
G. Current account (C+D+E+F)	-195	-346	-287	-298	-318	-335
H. Capital account	245	144	277	299	344	384
Long-term (net) 2/	201	97	227	249	294	334
Official	(142)	(32)	(155)	(169)	(205)	(236)
Private	(59)	(65)	(72)	(80)	(89)	(98)
Short-term (net)	44	47	50	50	50	50
I. Overall balance (G+H)	50	-202	-10	1	26	49
J. Financing	-50	202	10	-1	-26	-49
Gross reserves 3/	-24	36	--	-12	-37	-40
IMF (net)	-12	73	-90	-84	-56	-47
Other assets (net)	-14	--	--	--	--	--
To be secured	--	93	100	95	67	38
Memorandum items						
	(In percent of GDP)					
Current account deficit						
Including official grants	3.4	5.6	4.1	3.9	3.7	3.5
Excluding official grants	5.9	7.8	5.4	5.1	4.9	4.7
Official net capital inflow plus official grants	5.1	2.7	3.4	3.4	3.6	3.7

Sources: Data provided by the Kenyan authorities; and staff estimates.

1/ Projections based on following price and volume assumptions:

	Price projections			Volume projections		
	1984	1985	1986-89	1984	1985	1986-89
	(Average percent change over previous year)					
Exports	15.5	-5.4	5.0	0.3	4.0	5.4
Tea	(61.2)	(-16.0)	(5.0)	(-5.1)	(4.0)	(8.8)
Coffee	(12.2)	(-8.6)	(5.0)	(2.6)	(1.5)	(2.8)
Oil products	(-0.5)	(0.1)	(5.0)	(-6.7)	(4.0)	(2.3)
Other	(2.4)	(3.1)	(5.0)	(1.5)	(5.9)	(5.8)
Imports	1.6	2.9	5.0	15.8	5.4	2.0
Government	(2.3)	(4.0)	(5.0)	(83.3)	(18.1)	(-15.9)
Oil	(-0.5)	(0.1)	(5.0)	(4.3)	(1.5)	(1.0)
Other	(2.7)	(3.5)	(5.0)	(12.8)	(4.4)	(6.2)
GDP	9.0	8.0	5.7	--	4.0	5.4

2/ Assumes official and private long-term net capital between 1986 and 1989 of about 2 1/2 percent and 1 percent of GDP, respectively.

3/ Reserve level equivalent to 2.6 months of imports in 1986 and to 2.5 months thereafter.

excluding two large Eurocurrency loans, averaged 5.3 per cent of GDP.

At the end of 1983, close to 70 percent of Kenya's external debt was in the form of bilateral and multilateral loans on concessional terms, at well below market rates with long maturities and grace periods, and a significant grant element. Outstanding debt on commercial terms represents slightly over one fourth of the total, but due to heavy repayment on some of their loans in recent years, the proportion has been declining rapidly. Kenya's total outstanding external debt carries a maturity of about 25 years, a grace period of 6 years, an interest rate below 7 percent, and a grant element of over 30 years.

The contraction of Kenya's public and publicly guaranteed external loans has to be approved by the Ministry of Finance and Planning within the medium-term context of the Development Plan and the annual Central Government budgets and public sector's forward budgets. In addition, drawings on contracted loans and the scheduled servicing of the debt is closely monitored by the same ministry through the External Debt Reporting System (KEDRES), which registers transactions on all existing loans on a monthly basis. Kenya's debt service ratio is expected to peak in 1985 at 29 percent of exports of goods and services and private transfers compared to an estimated 28 percent in 1984. Assuming the financing of a current account deficit which would fall below 4 percent of GDP by 1988 and the utilization of a greater proportion of commercial type borrowing than in the past, the debt service ratio is projected to fall to 20 percent in 1988 (Table 10). Thus, Kenya is managing to handle its debt service commitments adequately. To ensure that Kenya's debt service is kept within manageable levels, the Government has undertaken to limit the contracting or guaranteeing of new debt on nonconcessional terms within the maturity range of 1-12 years to SDR 150 million, with a subceiling of SDR 100 million in the maturity range of 1-5 years. Moreover, only trade-related short term borrowing will be undertaken. The ceilings on medium- and long-term debt shall be adjusted downward by any use of short-term credits to finance grain imports.

The adjustments of the exchange rate effected since 1980 have been important in maintaining Kenya's competitive position. Although the Kenya shilling is fixed to the SDR, the flexible policy implemented during the previous stand-by arrangement has brought about frequent adjustments as required by movements in relative prices. At the present time the real effective exchange rate of the Kenya shilling is estimated to be about 2.5 percent over the rate reached at the start of the previous program as measured by the index utilized in monitoring the previous program. Although during the recent period in which the U.S. dollar strengthened, there has been a higher appreciation with respect to indexes which give the U.S. dollar a lower weight. The significance of this development will be a topic of discussion during the review of the arrangement, in light of the exchange rate patterns in existence then. As shown in Table 11, on the basis of the index used in the previous program, the present level is the same level that was attained following a 12.4 percent depreciation in 1975 when an extended arrangement with

Table 10. Kenya: Debt Service Projection, Summary Table, 1983-90

(Values in millions of SDRs; ratios in percent)

	1983	1984	1985	1986	1987	1988	1989	1990
Debt service								
Non-IMF principal 1/	186	207	224	194	190	189	205	205
Non-IMF interest 1/	130	131	133	138	153	163	179	190
Total non-IMF debt service	316	338	357	332	343	352	384	395
As percent of exports	22	22	22	19	17	16	16	15
IMF repurchases	43	58	70	90	84	66	107	85
IMF charges	26	46	44	41	33	25	16	9
Total IMF debt service	69	104	114	131	117	91	123	94
As percent of current receipts 2/	5	6	7	7	6	4	5	3
Total debt service	385	442	471	463	460	443	507	489
As percent of current receipts 2/	27	28	29	26	23	20	21	18
Memorandum items:								
Current receipts 2/	1,410	1,577	1,638	1,806	1,997	2,196	2,432	2,694
External debt outstanding	2,711	2,853	3,051	3,216	3,396	3,604	3,799	3,981
Disbursed 3/	2,711	2,853	2,629	2,435	2,245	2,061	1,873	1,708
Projected	--	--	422	781	1,151	1,543	1,976	2,273
External debt/GDP	51	52	49	46	44	42	39	37

Source: Data provided by the Kenyan authorities; and staff estimates.

1/ For fixed-interest loans, interest rates are assumed to decline from 5.4 percent in 1984 to 5.3 percent in 1990. The interest rates applied to flexible-rate loans are consistent with projections for the World Economic Outlook exercise which shows interest rates declining through the decade so that by 1990 LIBOR is 8.5 percent. A spread of 1.0 percent above LIBOR is assumed. New disbursements of fixed-interest rate debt are projected at SDR 1.05 billion for the five-year period, and are assumed to carry 30 years maturity and six years grace, which represents the average for these loans during 1973-83. New disbursements of the flexible-interest loans are projected at SDR 300 million, and assumed to carry six years maturity and three years grace.

2/ Excluding official transfers.

3/ As of December 31.

ment with the Fund was approved and the level targeted in previous programs. This level is considered to be appropriate by its historical context and the fact that in recent years it has allowed not only for the gradual liberalization of the import system, but also for overall balance of payments surpluses in 1983 and 1984. Apart from the small difference between the targeted real effective exchange rate and the actual rate at this time, Kenya's exchange rate policy is deemed to be appropriate by the staff in the present circumstances. The Government's intention to maintain the flexibility of the exchange rate is regarded as a key commitment under the present program. The adequacy of this policy will be a subject of discussion during the review of the arrangement. The Government plans to continue with its import liberalization policy and to rely on appropriate instruments of economic policy to keep imports to a financeable level. This will also be helped by the sustained improvement in terms of trade since 1982. The Government is keeping the exchange rate and other policies under continuous review to ascertain that these objectives are met. Under the current program, the Government will be shifting about 30 percent of items in Schedule 1B to Schedule 1A and to continue with the transfer of items from Schedule 2 to 1B. Progress in this area will be discussed with the authorities early during the program period and will be subject to the mid-term review.

Over the last 18 months, Kenya has made considerable progress in putting together a consistent set of domestic and external policies which have facilitated the liberalization of imports. Most remaining import restrictions have been imposed to protect local industry and not for balance of payments reasons. In many respects, the implementation of the import system has been more liberal than specified in the regulations, as exemplified by the value of licenses approved and the availability of goods even in the more restrictive categories. The authorities, however, have been concerned with the possibility of excessive stockpiling and have reviewed licenses even those in the automatic schedule for this possibility (see Appendix I).

The improved foreign exchange situation beginning 1983 permitted the authorities to adopt more liberal licensing procedures. In 1983 the value of import licenses increased by 56 percent. However, actual imports did not rise by as much, given that there is a lag of between two to four months between the time a license is approved and the goods actually arrive in the country. Thus, imports in 1983 were depressed largely as a result of the low level of import licenses issued in the last four months of 1982. Import arrivals have also been affected by a buildup in the amount of licenses approved, but not yet utilized. In 1984 there was a small further increase in the level of import licenses, yet nongovernment, non-oil imports are projected to rise by about 13 percent in SDR terms during the year, as the gap between licenses issued and used narrows.

Relations with the World Bank Group are covered in Attachment V.

Table 11. Kenya: Real and Nominal Effective Exchange Rates

(Period average; December 1982 = 100)

	Real effective exchange rate 1/	Nominal effective exchange rate 1/	Kenya shilling/ SDR rate 2/	Relative prices 3/
December				
1975	100.4833	138.2906	9.6577	138.18
1976	103.0580	141.0207	9.6652	138.91
1977	112.5540	137.0241	9.6744	123.27
1978	120.0453	137.7053	9.6731	115.94
1979	115.6428	137.7542	9.6643	119.05
1980	113.2889	133.5015	9.6572	117.58
1981	101.1670	109.0451	11.9423	107.79
1982				
March	103.9815	109.2073	11.9437	105.04
June	104.8435	109.1761	11.9456	104.17
September	107.2793	109.0955	11.9422	101.68
December	100.0000	100.0000	13.2031	100.00
1983				
March	97.4316	95.2984	14.0541	97.81
June	96.6310	94.0981	14.0887	97.38
September	96.9502	92.6168	14.4187	95.52
December	98.5550	93.6583	14.4158	95.00
1984				
March	103.8212	96.5166	13.9700	92.95
June	98.3532	90.7874	15.0069	92.27
July	99.9511	92.0110	14.9184	92.04
August	99.9958	92.0676	14.9410	92.05
September	103.5540	93.5288	14.8733	90.30
October	101.7122	91.8757	15.1321	90.29

Source: Data provided by the Kenyan authorities; and staff calculations.

1/ Weighted according to average of 1977-80 imports, with weights for the U.S. dollar adjusted to take account of third country trade denominated in U.S. dollars. Fall in index denotes depreciation of Kenya shilling.

2/ In Kenya shillings.

3/ A fall in the index indicates a relative increase in Kenyan consumer price index.

IV. Staff Appraisal and Proposed Decision

Kenya successfully implemented the program which expired in September 1984. The domestic and external adjustments sought under the program were met and the performance criteria specified were observed with substantial margins. The achievements accomplished were made possible by the willingness of the authorities to take additional actions as re quired to keep to the objectives of the program. The 1983/84 budget needed to be revised in several occasions as a result of the uncertainties involved in gauging the availability of resources. Difficulties in fine tuning fiscal and monetary policies also led the authorities to build margins under the performance criteria, developing a more cautious aggregate demand scenario than was actually required under the program.

The progress attained under the last program was already having an impact in promoting a more rapid rate of growth concomitant with the deceleration of inflation. The agricultural sector had begun to gain strength and the incentives being provided through producer prices were generating surplus grain production. The step by step progress made with import liberalization had normalized supply conditions and was permitting industry to utilize its capacity according to demand rather than availability of inputs. The flexible exchange rate policy being followed was helping to maintain Kenya's competitive position with beneficial results on tea and nontraditional exports. The reduced reliance on controls was allowing economic activity to flow more smoothly. The successful staging of Presidential and Parliamentary elections in September 1983 contributed to this outcome by improving confidence.

Having attained a substantial degree of stability, including a balance of payments position which appeared sustainable in the medium term, the authorities were in a better position to prepare a more adequate program of action for Kenya's medium term. The implementation of a new Five-Year Development Plan was expected to be the main instrument for the attainment of this objective. Unfortunately, Kenya's development aspirations have been side-tracked by the emergence of a major drought in 1984. Apart from the significant adverse impact of the drought on the population's welfare, the drought relief and reconstruction will have major financial, administrative, and balance of payments consequences. The magnitude of the task ahead requires the authorities to direct the full thrust of their economic and financial policies to ameliorate the impact of the drought. The substantial increase required in imported grains exceeds Kenya's financing capacity. The Government has requested international assistance in tackling this problem. Although many donor countries have already responded, commitments to date fall considerably short of the overall requirement. The balance of payments for 1985, even after taking into account resources coming from the Fund and a rundown in gross official reserves, includes an unfinanced gap of about SDR 93 million. Given Kenya's already high debt service ratio, it would be beneficial if most of the needed resources were obtained on concessional terms. The authorities are at present endeavoring to raise the additional resources required.

The proposed stand-by arrangement balances the substantial financial requirements resulting from the drought and the need to maintain a strong underlying position in the economy. Importantly, the thrust of economic and financial policies are geared to maintain the viability of the balance of payments in the medium term and to facilitate an upturn in economic activity, when the drought emergency is overcome. Key to the program is the promotion of an efficient allocation of resources and the continued easing of balance of payments pressures while a higher growth rate of income is attained. In this regard, the policy commitments with regard to producer prices, wages, interest rates, import liberalization, and the exchange rate form an important core of the program.

The fiscal policy followed in the last few years has permitted a substantial reduction in the overall budgetary deficit. The authorities' ability to maintain a tight expenditure policy and to adjust the fiscal targets as required by the turn of events was an important element in bringing this about. The program specified for 1985 will bring about a further adjustment in the underlying budgetary deficit, although permitting a temporary departure in relation to the expenditures needed for meeting the present emergency. It is important to stress that the budgetary targets in the program will be reduced as additional assistance is provided to Kenya during the year. Additional adjustment will, however, be required in the 1985/86 budget.

The authorities should redouble their efforts to gain a better financial control of public enterprises. The improvements already recorded in the form of reduced transfers need to be strengthened to encompass a better allocation of resources in the public sector by the incorporation of public enterprise into the forward budget. A better control of the public enterprises' access to bank credit needs to be established. Progress in this area could have a far reaching impact in allowing for a strengthened development effort.

The monetary objectives included in the program adequately balances the need for financing the drought relief with that of aiding the revival of the private sector economy, through the allocation of adequate credit resources. The maintenance of interest rates which are positive in real terms should provide the encouragement for a more efficient allocation of resources and the promotion of financial savings.

The balance of payments surpluses recorded in 1983 and 1984, the reduction of the current account deficit to under 3.5 percent of GDP, and the import liberalization attained, clearly point to the the progress achieved in the external area. The present program permits a deterioration in the current account deficit to take account of the emergency arising from the drought. The underlying strength of the balance of payments, however, will permit a return to a position which is self-sustaining in the medium term. In this regard, it is important for Kenya to begin firming up the resources which will be necessary for the implementation of the development plan once the emergency is overcome. The support granted by donors in the past has played an important role in the achievements recorded by Kenya. In the period ahead such assistance will be vital.

The balance of payments could be further strengthened by a more rigorous implementation of an export development program. Up to now export promotion has been largely limited to the maintenance of a competitive exchange rate. Although the continuation of this policy should remain the cornerstone of an export-oriented program, it will be important to offer to Kenya's producers, most of which have no experience in the international market place, increased support and encouragement. The Government has made progress in freeing the external sector in recent years through a more adequate exchange rate policy, a liberalization of the import system, and by facilitating outward remittances of investment income. The progress recorded in these areas needs to be strengthened by the continuation of the efforts in import liberalization. In the pursuance of this objective the Government needs to keep the exchange rate and other external policies under continuous review to ensure that they remain adequate to the changing circumstances and to the maintenance of the competitive position of the export sector. In this regard a further integration of a rational tariff structure, import liberalization, and exchange rate policy needs to be pursued.

Kenya's debt service ratio is expected to peak in 1985 and even under liberal assumptions as to additional capital borrowing in the next few years, it will show a marked decline through the rest of the decade. This adjustment will offer Kenya's policy makers a welcome relief. This improvement should be preserved and the authorities should continue to review carefully all external indebtedness with an effort to minimize commercial borrowing.

The staff believes that the measures incorporated into the program are appropriate to Kenya's prevailing circumstances. However, the margin of maneuverability enjoyed by the authorities is severely limited. If rainfall is inadequate in 1985, a substantial adjustment of economic policies and priorities will be required. The existence of an unfinanced gap at this point hinders the proper implementation of the program. The authorities should move quickly to fill the gap. It is hoped that donor countries will fully appreciate the progress recorded by Kenya under the previous stand-by arrangement and will be in a position to respond adequately to Kenya's request for additional assistance. The release of this assistance in a timely fashion will also allow the emergency relief to be handled promptly and adequately and the implementation of the program to be carried out on schedule. The staff expects to remain in close contact with the Kenyan authorities regarding the arrangements being made to fill the unfinanced balance of payments gap and the implementation of the program. The Kenyan authorities have already contacted their principal donors to seek additional assistance to meet the exceptional financing requirements arising from the drought. Discussions have also been held with commercial banks in these circumstances agreement on a program with the Fund would go a long way in removing uncertainty with respect to Kenya's pressing financing needs and the short-term nature of the disturbance by giving confidence that the policies in place are consistent with Kenya's medium-term adjustment efforts.

Accordingly, the following draft decision is proposed for adoption by the Executive Board:

1. The Government of Kenya has requested a stand-by arrangement for a period of one year for an amount equivalent to SDR 85.2 million.

2. The Fund approves the stand-by arrangement set forth in EBS/84/261.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Table I. Kenya: Gross Domestic Product, Deflator, Population, and Real Per Capita Income, 1974-83

	GDP at market prices 1976 prices	GDP at market prices Current prices	GDP deflator (Index 1976 = 100)	Population (In thousands)	Real per capita GDP (In Kenya shillings)
	(In millions of Kenya shillings)				
1974	27,695	21,167	76.54	12,912	2,145
1975	27,919	23,881	85.5	13,399	2,084
1976	28,993	28,993	100.0	13,847	2,094
1977	31,724	37,084	116.9	14,337	2,213
1978	34,024	40,996	120.5	14,856	2,290
1979	35,358	45,437	128.5	15,320	2,308
1980	37,053	52,649	142.1	15,909	2,329
1981	38,573	60,772	157.5	16,514	2,336
1982	39,272	67,989	173.1	17,142	2,291
1983	40,805	76,174	186.7	17,792	2,293
	(Annual change in percent)				
1974	4.5	21.3	16.1	3.4	1.0
1975	0.1	12.8	11.8	3.8	-2.8
1976	3.9	21.4	17.0	3.3	0.5
1977	9.4	27.9	16.9	3.5	5.7
1978	7.3	10.5	3.1	3.6	3.5
1979	3.9	10.8	6.6	3.7	0.8
1980	4.8	15.9	10.6	3.8	0.9
1981	4.1	15.4	10.8	3.8	0.3
1982	1.8	11.9	9.9	3.8	-1.9
1983	3.7	12.0	7.9	3.8	0.1
Avg. 1977/78	8.4	19.2	10.1	3.6	4.6
1979/81	4.3	14.0	9.3	3.8	0.7
1982/83	2.9	12.0	8.9	3.8	-0.9

Sources: Statistical Abstract, various issues; Kenya Statistical Digest, various issues; Economic Survey, various issues; data provided by the Kenyan authorities; and staff estimates.

Table II. Kenya: Consumer Price Indices, 1977-84

	Lower-income			Middle-income			Upper-income			Composite index 1/		
	Total	Food	Nonfood	Total	Food	Nonfood	Total	Food	Nonfood	Total	Food	Nonfood
(Base: January-June 1975=100; end of period)												
Weights		41.0	59.0		35.6	64.4		25.0	75.0		39.5	60.5
December												
1977	142.8	130.7	151.2	130.4	127.1	132.2	134.0	139.8	132.1	140.2	130.3	146.7
1978	162.3	147.8	172.4	141.0	141.1	140.9	145.1	149.9	143.5	157.7	146.6	164.9
1979	177.1	159.5	189.3	155.7	154.8	156.2	163.7	162.0	164.3	172.6	158.7	181.7
1980	200.3	185.3	210.7	173.3	178.0	170.7	185.4	185.1	185.5	194.7	183.9	201.8
1981	239.0	219.7	252.4	216.3	211.0	219.2	220.5	214.1	222.6	234.1	217.9	244.7
1982	270.8	241.6	291.1	255.9	228.6	271.4	259.0	231.6	268.5	267.6	238.8	287.5
1983	297.9	262.3	321.9	281.7	252.6	297.8	285.7	263.9	292.7	294.5	260.5	316.7
September												
1983	293.9	261.7	316.3	280.0	251.7	295.6	282.8	262.4	289.6	290.9	259.8	311.2
1984	323.6	294.3	344.0	302.6	286.7	311.4	304.8	291.1	309.4	319.0	292.8	336.1
(Annual percentage growth)												
December												
1977	21.0	17.2	23.4	13.5	14.7	12.8	13.8	17.4	12.7	19.4	16.8	21.0
1978	13.7	13.1	14.0	8.1	11.0	6.6	8.3	7.2	8.6	12.5	12.5	12.4
1979	9.1	7.9	9.8	10.4	9.7	10.9	12.8	8.1	14.5	9.4	8.3	10.2
1980	13.1	16.2	11.3	11.3	15.0	9.3	13.3	14.3	12.9	12.8	15.9	11.1
1981	19.3	18.6	19.8	24.8	13.5	28.4	18.9	15.7	20.0	20.2	18.5	21.3
1982	13.3	10.0	15.6	18.3	8.3	23.8	17.5	8.2	20.6	14.4	9.6	17.5
1983	10.0	8.6	10.6	10.1	10.5	9.7	10.3	13.9	9.0	10.1	9.1	10.2
September												
1984	10.1	12.5	8.8	8.1	13.9	5.3	7.8	10.9	6.8	9.7	12.7	8.0

Source: Data provided by the Kenyan authorities.

1/ The composite index has the following weights lower income 78 per cent, middle-income 19 per cent, and upper-income 3 per cent.

Recent Developments in Import Administration

Beginning in 1983 a liberal interpretation of licensing procedures was followed in some categories. Items in Schedule 1A were licensed automatically, except where there was evidence of overstocking by importers. This required a review of some licenses and led to a reduction in the automaticity of this category. Items in Schedule 1B were licensed liberally with the aim of meeting the expected domestic demand for these items. Items classified in Schedule 2A Special are allowed in automatically, following the approval of certain supervising agencies. This category includes mainly petroleum, petroleum products, and fertilizers. According to the 1983 classification, in 1982 Schedule 1A and 1B included 24.4 percent and 18.7 percent respectively of total imports and 39.0 percent and 29.8 percent, respectively of non-oil imports. Schedule 2A Special accounted for an additional 48.2 percent of total imports. Only the remaining 8.7 percent of imports, including many items which compete with domestic production and are being protected largely on infant industry grounds and some luxury items are being licensed restrictively.

In June 1984 there was a further liberalization of the import system: 306 items, over one quarter of the items in Schedules 2AO and 2B were shifted into Schedule 1, mainly Schedule 1B. This shift increased the number of items in Schedule 1 from 54 percent of the total to 65 percent while reducing Schedules 2AO and 2B to 32 percent from 43 percent. Also Schedules 2AO and 2B were merged into one.

The impact of recent changes can best be seen by a breakdown of imports under the different systems utilized since 1981. Measured on the basis of 1982 imports, Schedule 1 rose to account for 47.7 percent of imports on the basis of the 1984 system, compared to 43.4 percent under the 1983 system, with Schedule 1A and 1B increasing to 27.5 percent and 20.2 percent, respectively, compared to 24.4 percent and 18.7 percent previously. Compared to the system first introduced in 1981 Schedule 1 has increased by over 10 percentage points. With respect to non-oil imports, the new Schedule 1 is now equivalent to 77.2 percent of the total, with Schedules 1A and 1B totalling 44.6 percent and 32.7 percent, respectively (Appendix Table 1), compared to 39.0 percent and 29.8 percent, previously.

Table 1. Kenya: 1982 Imports by Import Schedule

(As percentage of total imports)

Schedules	Year of implementation 1981	1982	1983	1984
1	37.6	43.1	43.4	47.7
1A	...	...	24.4	27.5
1B	...	...	18.7	20.2
2	57.2	51.6	51.6	48.2
2AS	...	...	48.2	45.9
2AO	...	...	3.3	1.9
3 and 2B	5.3	5.3	5.3	4.5

Source: Data provided by Kenyan authorities; and staff estimates.

KENYA - Basic Data

Area, population, and GDP per capita

Area	580,000 square kilometers
Population: Total (1984)	19.5 million
Growth rate	3.8 per cent
GDP per capita (1984)	SDR 289

	1980	1981	1982	1983	1984
GDP (at 1976 market prices)					
Total (in billions of Kenya shillings)	37.1	38.6	39.3	40.7	40.7
Agriculture (per cent of total)	29	30	31	31	29
Manufacturing (per cent of total)	12	11	12	12	12
Government (per cent of total)	13	13	13	13	13
Annual real rate of growth (per cent)	4.8	4.1	1.8	3.9	--
Investment as per cent of GDP (at current market prices)	30	28	23	21	21
Prices (per cent change)					
GDP deflator	11	11	10	8	9
Cost of living index (annual average)	13	13	21	18	10
Cost of living index (end of period)	13	20	21	9	10

	1980/81	1981/82	1982/83	1983/84 Prelim. actual	1984/85 Revised budget
Central government finance 1/	(In billions of Kenya shillings)				
Total revenue	14.3	15.7	16.8	18.6	20.7
Foreign grants	0.5	0.9	1.1	1.0	2.2
Total expenditure	19.7	21.4	20.6	23.2	27.4
Recurrent	14.0	15.0	16.2	17.0	20.5
Development	5.7	6.4	4.5	6.2	6.9
Adjustment	-0.4	0.5	0.5	--	--
Overall deficit (-)	-5.4	-4.3	-2.2	-3.6	-4.5
Foreign financing (net)	2.8	1.1	1.2	0.8	1.4
Domestic borrowing (net)	2.6	3.2	1.0	2.9	3.1
Of which: from banking system	1.6	1.7	-0.1	0.7	2.1

1/ Fiscal year July 1-June 30.

KENYA - Basic Data (concluded)

	1980	1981	1982	1983	1984
Money and credit			(Per cent change)		
Domestic credit	14	28	26	0	12
Government	10	79	62	-19	22
Private sector	22	14	5	7	7
Money and quasi-money	3	13	14	7	13

	1980	1981	1982	1983 Prel.	1984 Est.
Balance of payments			(In millions of SDRs)		
Exports, f.o.b.	969	915	837	863	1,000
Imports, c.i.f.	-2,059	-1,850	-1,550	1,303	1,533
Trade balance	-1,090	-935	-713	-440	-533
Services and private transfers (net)	317	263	224	164	198
Official transfers (net)	92	66	68	113	140
Current account balance	-681	-606	-421	-163	-195
Capital account (net)	531	401	271	252	245
Official	317	175	145	75	142
Private	214	226	126	183	103
Of which: long-term	84	137	82	90	59
Allocation of SDRs	7	7	--	--	--
Overall surplus or deficit (-)	-143	-198	-150	89	50
Current account deficit as percent of GDP					
Including grants	-12.5	-12.2	-7.4	-3.1	-3.4
Excluding grants	-14.2	-13.9	-8.9	-5.2	-5.9
Gross official foreign reserves (end of period)	392	215	209	385	364
In weeks of imports	10	6	7	15	12
External public debt					
Disbursed and outstanding (end of period)	1,964	2,221	2,510	2,711	2,920
Debt service as per cent of exports of goods and non-factor services					
Excluding the Fund	12	17	21	23	22
Including the Fund	13	18	24	28	28

Kenya--Stand-By Arrangement

Attached hereto is a letter dated November 21, 1984 from the Minister of Finance and Planning and the Governor of the Central Bank, requesting a stand-by arrangement and setting forth

(a) the objectives and policies which the authories of Kenya intend to pursue for the period of this arrangement;

(b) the policies and measures that the authorities of Kenya intend to pursue through June 30, 1985; and

(c) understandings of the authorities of Kenya with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Kenya will pursue for the remaining period of the arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of twelve months from __________, 1984 Kenya will have the right to make purchases from the Fund in an amount equivalent to SDR 85.2 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 8.5 million through February 15, 1985, SDR 29.8 million through May 15, 1985, SDR 51.1 million through September 2, 1985, and SDR 68.1 million through December 2, 1985.

(b) None of these limits shall apply to a purchase under the standby arrangement that would not increase the Fund's holdings of Kenya's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota.

3. Purchases under this arrangement shall be made from ordinary resources and from borrowed resources in the ratio of 1 to 1, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Kenya shall not make purchases under this arrangement that would increase the Fund's holdings of its currency in the credit tranches beyond 25 percent of quota, or increase the Fund holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) during any period through June 30, 1985 in which the data at the end of the preceding period indicate that (i) the limit on net domestic credit of the banking system or (ii) the limit on net credit from the banking system to the Government, described in paragraphs 8 and 9 of the letter of November 21, 1984 is not observed; or

(b) after June 30, 1985, until the review contemplated in paragraph 19 of the letter of November 21, 1984, has been completed; or

(c) after June 30, 1985, until suitable performance criteria have been established in consultation with the Fund as contemplated by paragraphs 8 and 9 of the letter of November 21, 1984, or after such performance criteria have been established, while they are not being observed; or

(d) during the entire period of this stand-by arrangement, while Kenya has any overdue financial obligation to the Fund, or if Kenya

(i) fails to observe the limit on the contracting of public or publicly guaranteed external debt on commercial terms, described in paragraph 17 of the attached letter, or

(ii) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(iii) introduces or modifies multiple currency practices, or

(iv) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Kenya is prevented from purchasing under the arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Kenya and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Kenya's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Kenya. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Kenya and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Kenya, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's Rules and Regulations. Kenya will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(d).

8. Kenya shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Kenya shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Kenya's balance of payments and reserve position improves.

(b) Any reductions in Kenya's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the arrangement Kenya shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Kenya or of representatives of Kenya to the Fund. Kenya shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Kenya in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 20 of the attached letter Kenya will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Kenya has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Kenya's balance of payments policies.

Nairobi, November 21, 1984

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosière:

1. In 1984 Kenya is facing a major national disaster. Drought conditions have affected large portions of the main food growing areas, resulting in a large shortfall in grain production estimated at about 35 percent. Other agricultural output, including export products, has also been adversely affected. The national herd has been decimated and will require many years to recover. Consequently, during the 18 months ending December 31, 1985, the Government will need to import 1.4 million metric tons of grain. This large import requirement will tax not only Kenya's financing capacity, but also its transportation facilities if the delivery of grain to the needy is to be done on a timely basis.

2. The national emergency has required the marshalling of the Government's financial and administrative resources and a call for assistance from Kenya's friends. In meeting the drought relief, the Government is committed to minimize financial imbalances which may emerge, such that the underlying nondrought-related portion of the budgetary and balance of payments deficits are kept in line with the Government's goal of a sustainable balance of payments position. At the same time, despite the drought, progress will continue to be made in reducing structural imbalances. In order to help finance the balance of payments deficit which will emerge from the drought in 1985, the Government of Kenya would like to request a stand-by arrangement from the Fund for SDR 85.2 million. In addition, a purchase under the Compensatory Financing Facility will be requested as soon as the relevant information becomes available.

3. The Government is better placed to respond to the present crisis as a result of the success attained in the last few years in stabilizing the economy and reducing structural barriers to development. Since 1980/81 the overall budget deficit to GDP ratio has been more than halved, with a large reduction in the Government's recourse to bank credit. The external current account deficit has also been reduced from about 10 percent of GDP in 1980 to about 3 percent in 1983. The balance of payments recorded a surplus in 1983, raising gross foreign assets to a more adequate level. The external adjustment was carried out under very difficult conditions due to the deep recession in the international economy which resulted in a decline in Kenya's terms of trade.

4. In the course of the last few years, the incentives provided to the farmers in terms of increased producer prices have been important in raising output. Most recently producer and consumer prices for maize were raised by 9 percent and 15 percent respectively, following increases of 65 percent and 60 percent over the preceding three years. Wheat prices have also been adjusted by large margins. As a result of these policies there was a sizeable surplus in grain production in 1983, which facilitated the accumulation of a strategic grain reserve. This has become extremely important in enabling the Government to meet the present food shortfall. The Government will continue to review grain prices with the view to maintain adequate incentives.

5. Developments in the Kenyan economy had been influenced by the adjustment policies undertaken, by the negative international environment, and by structural constraints. However, the Government's success in bringing the fiscal and external accounts under control, coupled with the upturn in the world economy, was beginning to allow the removal of structural constraints to growth in the economy. For this purpose in late 1983, the Fifth National Development Plan was launched covering the five fiscal years beginning with 1984/85. The Plan was endorsed by the World Bank and was presented to donors in early 1984. A consistent investment program, also reviewed by the World Bank, was incorporated in the 1984/85 budget. The major financing requirements which have arisen from the drought will unfortunately result in a delay in the effective implementation of the Plan. Not only has it become necessary to delay projects, but also resources in the economy are being usurped by drought-related requirements. Despite the unfortunate delay in public investment, the Government intends to move forward with structural reform in the fields of production, external trade, finance, and public finance management.

6. Under normal climatic conditions the growth of income would have strengthened in 1984-85, with reduced financial pressure from the public sector and a further strengthening of the balance of payments. Because of the drought, real income is now projected to stagnate in 1984, largely due to the reduction in grain output, a fall in the livestock herd, and reduced tea production. The industrial sector is also being affected by the inadequate supply of agricultural inputs. With the return of normal weather conditions in 1985, real income growth could rebound to about 4 percent. This target will be facilitated not only by a return to a more normal harvest, but also by the maintenance of price incentives, a cautious wage policy, and an adequate supply of imports to the economy.

7. The Government intends to minimize the domestic financial repercussions of the drought by containing other expenditures in order to generate savings for drought relief. The overall budgetary deficit is to be kept to about 5 percent of GDP in 1984/85, compared with 4.6 percent in 1983/84. The generous response of some donors has permitted a reduction of the domestic financing required for the drought. Presently, the net impact of the drought on the budget is estimated at 1.0 percent of GDP. The underlying budgetary deficit is estimated at 4.1 per cent of GDP, compared with about the same percentage as in 1983/84, if the budget

deficit for that year is adjusted for the unusually large expenditure carryover equal to about 0.5 percent of GDP. The Government will take additional measures if needed to keep the overall deficit to the agreed targets. This deficit is considered to be consistent with movement toward a sustainable level over the medium term.

8. In order to finance the higher deficit resulting from the drought, the Government will temporarily increase its access to net bank borrowing above a level which it considers prudent over the long-run. It intends to fully revert to a more reasonable level of net bank financing as soon as the crisis of the present drought is over. The adjustment necessary in government finances to meet the target for the overall deficit has been approved by the Cabinet, including cuts in outlays and a reorientation toward drought relief. The financial burden on the budget has been reduced by the recent increase in the consumer prices for grains. A review of government employment is presently being undertaken and the Government intends to severely limit additional hirings. Included within government expenditures and thus in the overall deficit are the additional resources required by the National Cereals and Produce Board (NCPB) to carry out its activities during the drought emergency. The Government will carefully oversee the finances of NCPB to ascertain that it stays within its budgetary allocations. In order to meet the target on the overall deficit, the Government will limit its net borrowing from the banking system--net of the deposits with the Treasury of the Cereals and Sugar Finance Corporation (CSFC)--to K Sh 9,245 million on December 31, 1984, K Sh 8,754 million on March 31, 1985, and K Sh 8,638 million on June 30, 1985. These limits shall be adjusted downward after January 1, 1985 by any net external loans and grants channeled through the budget above the level assumed in the present program, excluding grants earmarked for specific projects. The deduction proposed on additional foreign borrowing is designed to limit the underlying budgetary deficit to the agreed target. The Government will reach understandings with the Fund prior to June 30, 1985 on the budgetary policies to be put into place in FY 1985/86 and on the applicable credit ceilings on net government credit for the remainder of the program.

9. For 1985 an overall balance of payments financing need of SDR 272 million is foreseen. To meet this financing need, the Government plans to utilize some of its reserves, have recourse to Fund credit, and meet the remaining gap by securing additional loans and grants. Consistent with this plan, the monetary program has been designed so that money and quasi-money will increase by 8.1 percent in FY 1984/85. Accordingly, net domestic credit of the banking system, which was K Sh 25,030 million on June 30, 1984, will not be allowed to exceed K Sh 28,365 million on December 31, 1984, K Sh 27,913 million on March 31, 1985, and K Sh 29,527 million on June 30, 1985. These limits shall be adjusted downwards after January 1, 1985 by any net external borrowing other than from the IMF undertaken by the Government to meet the presently projected financing gap and utilized through the budget. Interest rates were increased by about 6 percentage points since June 1980 and have been positive in real terms since December 1982.

The Government intends to keep interest rates under continuous review to ensure that they remain positive in real terms. The Government of Kenya will reach understandings with the Fund prior to June 30, 1985 on the monetary policy to be followed in FY 1985/86 and the credit ceilings for the remainder of the program.

10. During 1984 Kenya has benefited from an improvement in tea prices, as well as in other export earnings and services. However, the need for grain imports has generated pressures on the balance of payments, which are fortunately being eased by donations from abroad. Thus, despite the expectation that nongovernment, nongrain imports will rise by about 20 percent in 1984, compared with 3 percent in the previous year, the balance of payments is projected to record a surplus of SDR 50 million, following a surplus of SDR 89 million in the previous year. This will allow an increase in gross reserves to the equivalent of three months of imports at the end of 1984. The strengthened balance of payments position attained in 1983-84, including the reduction of the current account deficit and the overall surpluses recorded, have enhanced Kenya's ability to meet the large drought-related financing requirement expected in 1985.

11. The balance of payments financing need presently projected includes a financing shortfall of about SDR 93 million. Some additional resources are expected as foreign donors respond to the drought crisis.

12. The need for large-scale grain imports in 1985 will be mainly responsible for the increase in the current account deficit of the balance of payments to the equivalent of 5.6 percent of GDP from 3.4 percent in 1984. In the absence of the drought, the current account deficit for 1985 is projected at 3.8 percent of GDP. The Government intends to maintain the underlying viability of the balance of payments, while at the same time moving toward a more liberal import administration. In the past an active exchange rate policy has been followed to provide needed incentives to exporters. Between 1980 and September 1984 the exchange rate for the Kenya shilling was depreciated by 50 percent in U.S. dollar terms. Additional action is contemplated in order to keep the real effective rate at an appropriate level. The Government intends to keep the exchange rate under continuous review in order to attain this goal.

13. The Government plans to develop a more comprehensive export promotion program involving, among other things, export finance, a reduction of regulations for exporters, and in-bond production. These measures are expected to supplement the benefits derived from the exchange rate policy in promoting nontraditional exports. In this respect, local production also needs to be encouraged to become more competitive. The Government's efforts to liberalize the import system, which began in 1980, have suffered some delays resulting from unforeseen balance of payments difficulties. The Government is fully committed to the objective of import liberalization and is making progress toward meeting this objective.

14. A new import system was introduced in June 1983. Since then there has been a progressive liberalization of the licensing system, assisted by the improvement in the foreign exchange situation. The liberalization of the restrictive system permitted rapid growth in the value of import licenses and a significant increase in imports. As a result of decisions made in June 1984, 306 items (11 percent of the total and one quarter of those in the restricted categories) were transferred out of the two restrictive categories mainly into Schedule 1B. The two restrictive categories were reduced and merged into one. It has been the aim of the authorites to allow imports under Schedule 1A to flow in almost automatically, while allowing those in 1B to meet expected domestic demand for these items. These policies have been followed, except where there is evidence of overstocking. Items in category 2A Special are allowed in automatically following the approval of certain supervising agencies. The most important items in this category are petroleum and fertilizers. The remaining two categories, now merged into one, include items which compete with domestic production, which are being protected largely on infant industry grounds.

15. After the recent adjustment, category 1A contains 30 percent of import items, with 1B and 2AS containing an additional 35 percent and 3 percent, respectively. Thus, over two-thirds of all import items are being licensed in a liberal manner. In terms of 1983 import values, 1A accounted for 32 percent of the total, with 1B and 2AS reaching 19 percent and 44 percent, respectively. The restrictive category accounts for 32 percent of import items and 5 percent of 1983 imports value. In terms of items, the restrictive category is now equal to only three-quarters of the combined old categories of 2AO and 2B. The relaxation of the restrictive system is indicated also by the projected increase in imports, excluding fuel, food, and other government imports, in 1984 of 20 percent, compared with less than 3 percent in 1983. Despite the balance of payments difficulties foreseen, the Government plans to preserve the progress attained in liberalizing the import system relying on appropriate instruments of economic policy to keep imports to a financeable level.

16. In the context of obtaining the needed financing for the 1985 balance of payments, the Government intends, with technical assistance from the Fund, to shift 30 percent of the items in Schedule 1B to 1A by June 30, 1985 and to carry out a further transfer from Schedule 2A to 1B. Steps are being taken to ensure that import authorization for items in 1A is automatic; while imports in Schedules 1B and 2AS will continue to be made in a liberal manner. The Government is studying whether adjustments in tariffs and a more active exchange rate policy may be needed to carry out these objectives.

17. In 1984 Kenya's debt service ratio (including IMF) is estimated at 28 percent but it is expected to decline rapidly after 1985. The Government, including the Central Bank, intends to limit the contracting of public and publicly guaranteed external borrowing on nonconcessional terms in the maturity range 1-12 years to SDR 150 million of which SDR 100 million will be in the 1-5 year range. At the present time,

the Government does not have any short-term debt. However, the financing of the grain imports may require the use of net trade credits of up to 1 year maturity to allow for an orderly management of external payments. To the extent that such financing is utilized, the ceilings on medium- and long-term debt will be reduced accordingly. No other short-term financing by the Government or nontrade related borrowing by the public sector will be undertaken.

18. Also, for the duration of the program period, the Government of Kenya does not intend to introduce or modify any new multiple currency practice, impose new or intensify existing restrictions on payments and transfers for current international transactions, conclude bilateral payments agreements which are inconsistent with the Fund's Article VIII, or introduce new or intensify existing restrictions on imports for balance of payments reasons.

19. In order to adequately monitor the progress in implementing the program, the Government of Kenya intends to reach understandings with the Fund prior to June 30, 1985 on the fiscal, monetary, import and exchange and interest rate policies in the light of the objectives stated in this letter.

20. The Government of Kenya believes that the policies set forth in this letter are adequate to meet the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Kenya will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund.

Yours sincerely,

/s/
P. Ndegwa
Governor of the Central
Bank of Kenya

/s/
Professor George Saitoti
Minister of Finance
and Planning

Kenya: Relations with the Fund

(As of October 31, 1984)

I. Membership status:

(a) Date of membership	February 3, 1964
(b) Status	Article XIV

A. Financial Relations

II. General Department

(a) Quota		SDR 142.0 million
(b) Total Fund holdings of Kenya's currency		SDR 524.12 million (369.10 percent of quota)
(c) Fund holdings of Kenya's currency subject to repurchase		SDR 393.01 million (276.77 percent of quota)
Of which:	Credit tranche	SDR 80.04 million (56.37 percent of quota)
	SFF	SDR 86.39 million (60.84 percent of quota)
	E.A.R.	SDR 166.21 million (117.05 percent of quota)
	C.F.F.-C.	SDR 60.38 million (42.52 percent of quota)

III. Current Stand-By or previous arrangements and special facilities

(a) Current stand-by: none.

(b) Previous arrangements:

1 extended arrangement approved in July 1975, and
5 stand-by arrangements approved respectively in November 1978, August 1979, October 1980, January 1982, and March 1983. Amounts range from SDR 17.25 million to SDR 241.50 million.

Kenya: Relations with the Fund (continued)

(c) Special facilities approved included oil facility, Trust Fund loans, SFF subsidy account and compensatory financing facilities for export shortfalls and cereal imports.

IV. SDR Department

(a) Net cumulative allocation - SDR 36.99 million
(b) Holdings: amount to 5.92 million or 16.00 percent of net cumulative allocations.

V. Administered Accounts

(a) Trust Fund loans:

(i) Disbursed - SDR 46.91 million
(ii) Outstanding - SDR 43.32 million

(b) SFF Subsidy Account:

(i) Payments by Fund - US$5,966,829.29

VI. Overdue Obligations to the Fund: none

B. Nonfinancial Relations

VII. Exchange system: Pegged to the SDR at K Sh 14.79 = 1 SDR (since May 15, 1984), within margins of 2.25 percent of the rate.

Intervention currency and rate - U.S. dollar
K Sh 15.12 = US$1.

VIII. Last Article IV Consultation and Stand-By Review.

Article IV, January-February 1984 (EBS/84/79) discussed by the Executive Board on May 16, 1984 - (EBM/84/78). The following Decisions were adopted:

1984 Consultation

1. The Fund takes this decision relating to Kenya's exchange measures subject to Article VIII, Section 2, and in concluding the 1984 Article XIV consultation with Kenya, in the light of the 1984 consultation with Kenya, conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

Kenya: Relations with the Fund (continued)

2. Kenya maintains restrictions on payments and transfers for current international transactions subject to approval under Article VIII, Section 2, arising from limitations on foreign exchange for certain imports, and for divident and rental income remittances. In the circumstances of Kenya, the Fund grants approval for their retention until March 31, 1985, or the next Article IV consultation with Kenya, whichever is the earliest.

Review Under Stand-By Arrangement

1. Kenya has consulted with the Fund in accordance with paragraph 4 (b) of the stand-by arrangement for Kenya (EBS/83/41, Supplement 1, 3/23/83) and paragraph 16 of the letter of the Minister of Finance and the Governor of the Central Bank of Kenya dated January 28, 1983 annexed thereto in order to review policies and to establish performance criteria subject to which purchases may be made by Kenya.

2. The letter dated March 27, 1984 from the Minister of Finance and the Governor of the Central Bank of Kenya setting forth certain policies and measures which the authorities will pursue shall be annexed to the stand-by arrangement of Kenya, and the letter of January 28, 1983 supplemented by the letter of September 13, 1983, shall be read as supplemented by the letter of March 27, 1984.

3. Accordingly, Kenya will not make purchases under the stand-by arrangement that would increase the Fund's holdings of Kenya's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota during any period in which the data at the end of the preceding period indicate that the limit on total domestic credit of the banking system described in paragraph 6 of the letter of March 27, 1984 or the limit on net credit from the banking system to the Government described in paragraph 5 of the letter of March 27, 1984, are not observed.

4. With respect to the fiscal, monetary, import, and exchange and interest rate policies, the Fund finds that no additional understandings are necessary.

5. Paragraph 4(c) of the stand-by arrangement for Kenya in EBS/83/41, Supplement 1, March 22, 1983, shall be amended to read as follows:

(c) during the entire period of this stand-by arrangement, while Kenya has any overdue financial obligations to the Fund, or if Kenya ...

Kenya: Relations with the Fund (concluded)

Kenya is on a 12-month cycle for Article IV consultations.

IX. Technical Assistance

CBD: One expert assigned to Central Bank of Kenya.
Technical assistance missions on Kenya Financial System (March and May-June 1984).

FAD: Technical assistance in fiscal field (1981).

Relations with the World Bank Group

The World Bank has a large ongoing program in Kenya. As of June 30, 1984 it has committed almost SDR 1 billion, of which SDR 527 million have been fully disbursed.

1. Agriculture

As the dominant sector in the Kenyan economy, agriculture has received about 12 percent of all World Bank group lending and is expected to obtain over 13 percent of proposed lending by the Bank. The main existing projects related to the extension of development activities to smallholders in the Rift Valley and Coast Province (US$46 million) (Table 1); rural health and family planning (US$23 million); the rehabilitation and expansion of sugar factories and improvement of irrigation and drainage, etc. (US$72 million); and the promotion of institutional strengthening in the areas of financial management, credit training, and data processing of agricultural credit (US$25 million). Proposed projects relate to dairy farming (US$45 million); agricultural research (US$30 million); agricultural training and institutionalization (US$50 million); and parastatal management, private sector marketing and processing (US$45 million).

2. Industry

To date, Kenya's industry has been the leading recipient sector of World Bank's lending with 15 percent of the total. However, it is anticipated to share only 3 percent of the proposed lending, essentially due to the still ongoing process of reorientation of the Kenyan economy toward export markets. The main existing projects relate to the financing of Kenya's Industrial Development Bank (US$30 million) and small scale industry (US$10 million).

3. Energy

The Bank's efforts on this sector have thus far concentrated on lessening Kenya's dependency on imported oil and preventing deforestation. The sector has received over 10 percent of the World Bank's total past lending, and the main projects have been the Olkaria Geothermal Power project (US$52 million) and the petroleum exploration project (US$4 million). Proposed energy projects represent 8 percent of the Bank's lending, with a US$50 million loan for energy management and a US$50 million loan for geothermal exploration.

4. Transport

While in the past this sector has received only 9 percent of the Bank's total lending, it is slated to receive over 19 percent of proposed lending. A highway project (US$90 million) and the promotion of

Table 1. Financial Relations of the World Bank Group with Kenya

(As of June 30, 1984)

Date of membership: February 3, 1964
Capital subscription: SDR 40.0 million

	World Bank loans			IDA and Third Window loans			Total	
	Net committed	Disbursed	Disbursement ratio	Net committed	Disbursed	Disbursement ratio	Committed	Disbursed
Agriculture, livestock, and rural development	119.5	49.3	41.3	162.5	38.6	23.8	282.0	87.9
Population	--	--	--	23.0	1.9	8.3	23.0	1.9
Education	10.0	7.3	73.0	63.0	12.6	20.0	73.0	19.9
Tourism	17.0	11.4	67.1	--	--	--	17.0	11.4
Energy and petroleum exploration	56.0	38.7	69.1	--	--	--	56.0	38.7
Industries and development finance institutions	48.2	29.8	61.8	10.0	4.1	41.0	58.2	33.9
Utilities	90.0	49.7	55.2	47.0	16.4	34.9	137.0	66.1
Transport	152.0	96.5	63.5	--	--	--	152.0	96.5
Telecommunications	64.7	39.3	60.7	--	--	--	64.7	39.3
Structural adjustment loans	60.9	60.9	100.0	70.0	70.0	100.0	130.9	130.9
Technical assistance	--	--	--	4.5	0.2	4.4	4.5	0.2
Total	618.3	382.9	61.9	380.0	143.8	37.8	998.3	526.7
Repayments	Bank:	74.6		IDA:	4.2		W.B. Group:	78.8
Debt outstanding	Bank:	543.7		IDA:	375.8		W.B. Group:	919.5
Total undisbursed	Bank:	235.4		IDA:	236.2		W.B. Group:	471.6

IFC operations

Promotion of tourism facilities, capital markets, industrial development (pulp and paper, textiles, cement) and development financing. Total net commitments on loans and equity held by IFC amount to US$43.1 million, of which US$36.6 million have been disbursed.

Source: World Bank.

promotion of railways (US$58 million) account for most of the past lending. The main future loan relates to railways (US$130 million).

5. Structural Adjustment Loans

The World Bank has negotiated and fully disbursed two structural adjustment loans to Kenya. The first one, negotiated in March 1980, was for US$70 million and was fully disbursed by September 1980. The second one, negotiated in July 1982 for SDR 130 million was disbursed in two tranches: one in September 1982 and the second in January 1984.

The World Bank is not presently contemplating the negotiation of a third structural adjustment loan. Despite the fact that the previous two loans were fully disbursed, the Bank remains dissatisfied at the degree to which Kenya met the commitments included under the program. The SAL programs have been implemented under adversed external circumstances which negatively affected Kenya's performance. The protracted balance of payments crises of 1981 and 1982, as well as the coup attempt in August 1982, forced adjustments in the Government's policies and led to delays and reversals in policy initiatives included in the SAL programs. Implementation was also affected by a shortage of technical personnel and the preoccupation of the authorities with short-term stabilization efforts. In addition problems were encountered with the timing of required studies and the role of some technical assistance personnel. The present stand-by arrangement seeks to further progress in the forward budget, in development planning and in the liberalization of imports, elements which also form part of the structural adjustment program.

Through Bank assistance, the necessary studies of effective import protection have begun. The Bank is also likely to respond to a request from the Government of Kenya for a review of the forward budget early in 1985. The Bank and the Fund share a common concern on the need to make faster progress in these areas.

Although some agreements in principle were made between the Government of Kenya and the Bank on the reform of the grain marketing system, the current drought crisis has led the Government to postpone the implementation of the reform. The Bank would also like larger expenditures in population control.